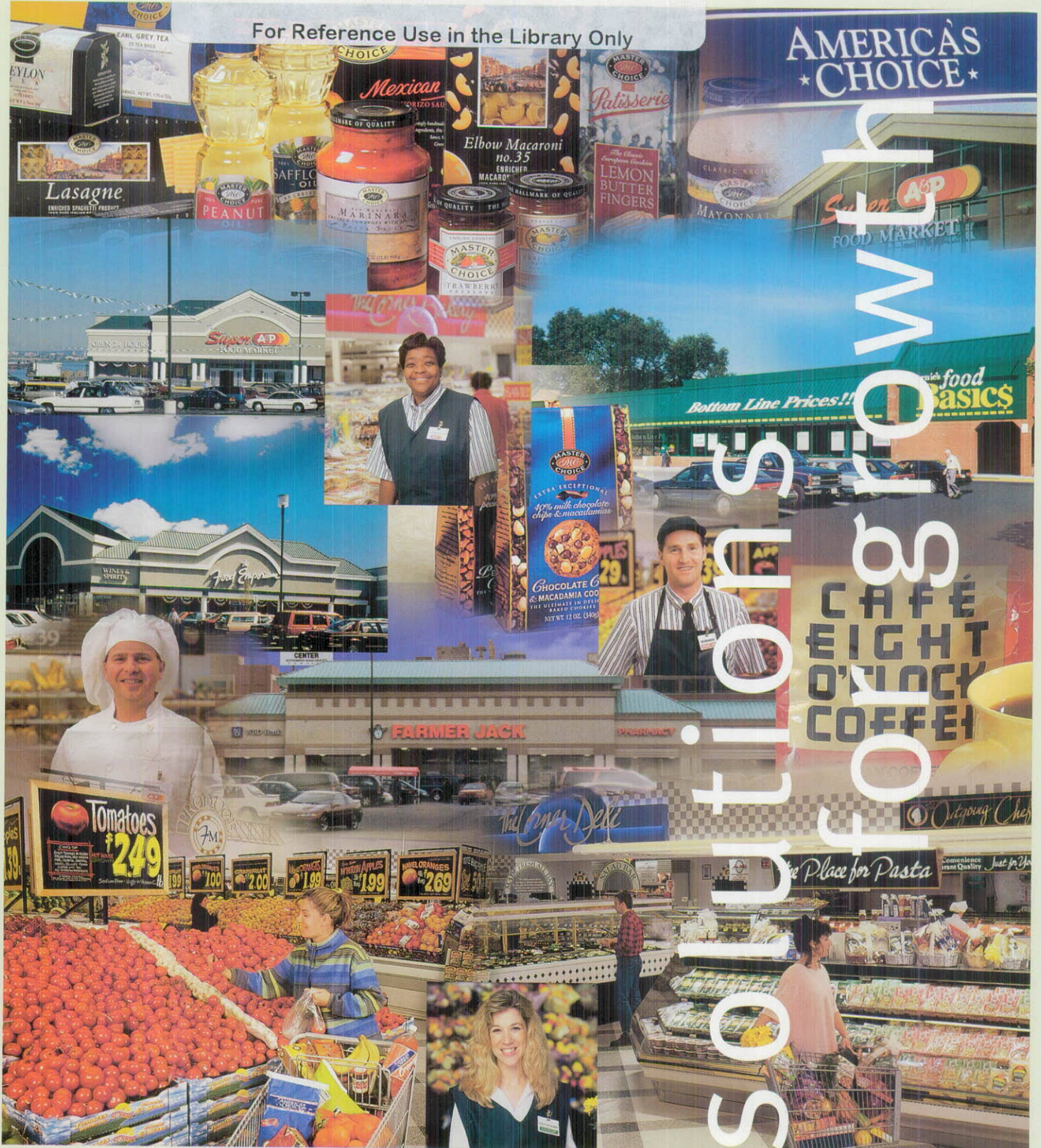


COMPANY REPORTS  
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1997 Annual Report

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## Comparative Highlights

	The Great Atlantic & Pacific Tea Company, Inc.		
(Dollars in thousands, except per share amounts)	Fiscal 1997 (53 weeks)	Fiscal 1996 (52 weeks)	Fiscal 1995 (52 weeks)
Sales	\$10,262,243	\$10,089,014	\$10,101,356
Income from operations	155,259	169,303	151,734
Income before extraordinary item	63,586	73,032	57,224
Net income	63,042	73,032	57,224
Income per share before extraordinary item - basic and diluted	1.66	1.91	1.50
Net income per share - basic and diluted	1.65	1.91	1.50
Cash dividends per share	.40	.20	.20
Expenditures for property	267,623	296,878	236,139
Depreciation and amortization	234,236	230,748	225,449
Working capital	262,097	215,374	190,967
Shareholders' equity	926,632	890,072	822,785
Debt to total capitalization	.48	.49	.49
Book value per share	24.22	23.27	21.53
New store openings	40	30	30
Number of stores at year end	936	973	1,014
Number of franchised stores served at year end	52	49	7

## Company Profile

The Great Atlantic & Pacific Tea Company, Inc. ("the Company"), based in Montvale, New Jersey, operates combination food and drug stores, conventional supermarkets and limited assortment food stores in 18 U.S. states, the District of Columbia and Ontario, Canada, under the A&P, Waldbaum's, Food Emporium, Super Fresh, Farmer Jack, Kohl's, Sav-A-Center, Dominion, and Food Basics trade names. As of the fiscal year ended February 28, 1998, the Company operated a total of 936 stores, and served 52 franchised stores. Through its Compass Foods Division, the Company also manufactures and distributes a line of whole bean coffees under the Eight O'Clock, Bokar and Royale labels, both for sale through its own stores as well as other food and convenience retailers.

## About the Cover

"Solutions for Growth" is the focus of this year's annual report. A&P is committed to enhancing the shopping experience for all of our customers. Through our capital development program we are expanding our store base and offering customers bigger and better stores to shop in than ever before. A&P customers will find a tempting array of choices, from the freshest prepared foods to the highest quality produce available anywhere, complemented by in-store banks and pharmacies. But shoppers will find more than quality and convenience at the right price. Thanks to new training programs, they'll also discover that A&P employees can make their weekly shopping trip even easier. With these solutions in place, A&P is looking to a future of strong growth.

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A&P moved forward in 1997 as we continued to implement our capital investment program for store renewal and strengthened our position in core markets.

For the 1997 fiscal year ended February 28, 1998, A&P recorded income of \$63,586,000 or \$1.66 per share, as compared to \$73,032,000 or \$1.91 per share in fiscal 1996. Sales rose in 1997 to \$10,262,243,000, up from \$10,089,014,000 the previous year, primarily due to an extra week in the year. All but two areas of A&P recorded higher profits in 1997 versus 1996. Earnings for the year were adversely impacted by profit declines at Super Fresh in Philadelphia and Waldbaum's in Long Island, but we were particularly pleased with results in our three largest groups: Metro New York, Canada and Michigan.

A&P's capital plan continues to accelerate. We opened 40 new stores in 1997 and plan to open at least 45 more in 1998. In addition, we remodeled or enlarged 45 stores this year and expect to modernize 80 more in 1998. In 1997, we invested nearly \$270 million in revitalizing our stores; we expect to invest \$300 million in the upcoming year.

As the number of new stores increases and smaller outmoded stores are replaced, the Company's overall sales and profits can be expected to improve.

Within our total store population the modern up-to-date stores have consistently shown sales increases while

the small outmoded stores have continually declined. As the modern facilities account for an increasing share of our total business, the dilutive effect of the small stores becomes less significant.

In some of our market areas, where the modernization program is more advanced, this is already happening. Michigan and parts of the New York area have already tipped the balance in favor of an overall sales and profit improvement trend with a majority of our business growing through newer stores.

An essential part of this store replacement program is an aggressive remodeling schedule for those facilities in our core areas that have the potential to be enlarged and remodeled to competitive state-of-the-art supermarkets. As noted previously, remodels in 1998 are expected to be almost double that of 1997.

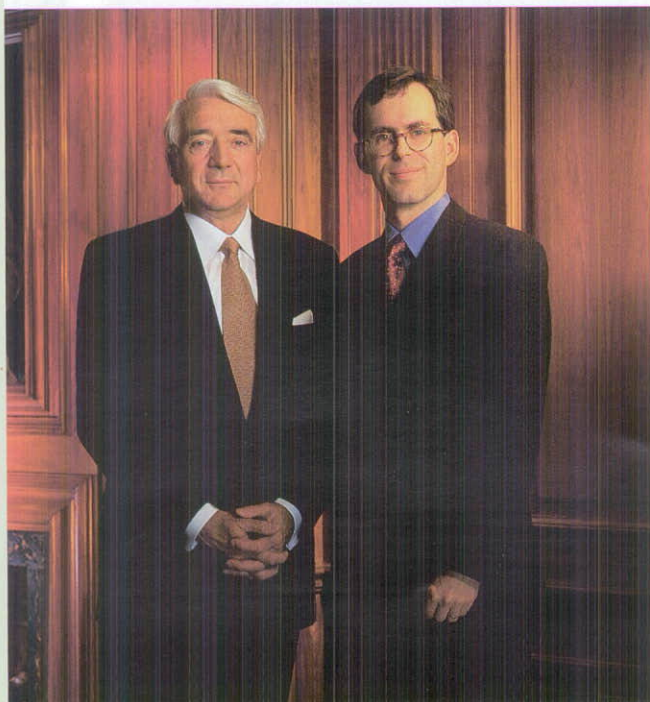
In late 1997, we finalized the formation of a new senior management team that will take the Company into the new millennium. Alongside the capital development strategy, previously described, a number of objectives have been identified to achieve the superior returns which the Company has targeted for the future.

First, A&P's product offering will highlight value, variety and convenience. Perishables, in particular, will be the best in each of our marketplaces.

Private label products have now been totally consolidated under the *America's Choice* and the upscale *Master Choice* labels and offer the greatest value and quality to our customers. We anticipate that these two brands will account for up to 20% of our total sales in future years.

Our trading hours, service departments and products will be tailored to each neighborhood so that we can identify closely with each area's customer-base requirements.

Our people will be trained to be customer focused. They will benefit from the advanced training programs which are now in place, the new technology which is now available to them, and the motivation and incentive programs in place and planned for the future.



(left to right)

James Wood  
Chairman of  
the Board

Christian W.E. Haub  
President and  
Chief  
Executive Officer

MANCHESTER  
BUSINESS SCHOOL

09 JUN 1998

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Finally, our cost of operation is being progressively reduced to produce the lowest possible break-even point. This will enable the Company to deliver both the best value to its customers and a shareholder return commensurate with the best performance in the supermarket industry.

A priority objective is to find long-term solutions to the challenges we have at Waldbaum's and Super Fresh. In the case of Waldbaum's, we have a strong management team in place that is implementing a comprehensive marketing strategy in a very competitive environment on Long Island. That strategy includes an aggressive new store development program, extensive renovations in our existing excellent locations and a re-emphasis on the traditional Waldbaum's perishables departments.

At Super Fresh in Philadelphia, we have 70 stores and an 11% market share. We brought in new management last year, added four new stores, and have four more planned this year. We are in the process of re-merchandising all existing stores and will be initiating new marketing and promotional programs in 1998. The major problem in the Philadelphia market, however, is the expansion of non-union competition with labor-cost advantages that are upsetting what used to be a more level playing field.

Also, high in our priorities is the continuation of our program to improve and build our franchise in the Company's core markets; Metro New York, Canada and Michigan. A short description provides some detail of our Company's position in each of these three core markets.

#### **Metro New York**

In Metro New York, we operate 148 A&P stores, 85 Waldbaum's and 35 Food Emporiums for a 20% share of the market. We added ten new or replacement stores in this market in 1997 and have 14 more scheduled for 1998. Five of the 14 will be new Waldbaum's, providing a solid marketing thrust on Long Island. We are reintroducing "The Great Store Just Next Door" advertising theme for Metro New York A&P to highlight the great new stores we have opened in the market over the past three years. We will also strengthen our hold on the Food Emporium shopper in New York with three new Food Emporium stores.

#### **Canada**

In Canada, we operate 85 Dominion stores in Metro Toronto, 94 A&P's outside of Toronto and 60 Food Basics stores (8 Company-owned and 52 franchised) for a 23% market share in Ontario. In 1997, our Canadian operations continued to improve with positive sales and earnings trends. We expect 1998 to also be positive.

By far, the most important event that has taken place in Canada in recent times has been the creation of the Food Basics concept which is now the lowest priced food store format in the Ontario market. Their success has enabled us to convert loss-making stores and to take advantage of improved buying opportunities. As greater sales volume has been generated, costs have improved across the board by the sharing of distribution and overhead expenses with the new stream of retailing.

A more competitive labor contract with our unions is an essential factor in our new upcoming store development program to avoid a repetition of the problem we endured in the early 90's before we introduced the Food Basics format. We expect to achieve this in the coming year when we finalize our new development program in Canada.

#### **Michigan**

Enhanced store formats, improved operating standards, and increased marketing efforts have helped move the 101 Farmer Jack Stores in Michigan into the dominant market position in Metro Detroit with a 28% share. With expanded departments and the addition of new conveniences, such as in-store banks and pharmacies, Farmer Jack Stores are becoming the solution to more and more customers' weekly shopping needs. We opened seven new Farmer Jack Stores in 1997 and have several more planned in 1998.

#### **Other Operations**

Also in the Midwest, Kohl's, a 1983 acquisition and one of the Company's most stable performers, is growing with new stores and expansions.

In addition to our three core markets, we have developed several strong footholds: New Orleans, Atlanta, Mid-Atlantic and New England. In New Orleans, we have been building large new Sav-A-Center stores in the 90's, with strong profitable results, particularly in 1997.

The acquisition of Big Star in 1992 solidified a weak presence in Atlanta. We have subsequently established the A&P franchise in this growing market that has seen some major food retailer fallouts.



Our Mid-Atlantic presence is growing in profitability with the help of new stores in recent years. This market area now includes our Virginia stores, where we maintain a good presence after disposing of the smaller, unprofitable stores in the Carolinas.

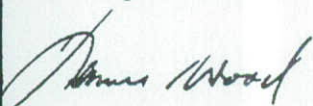
Finally, in New England, we are concentrating on improving the profitability of our larger, newer stores under the Super Foodmart banner. We are still maintaining a strong cluster of A&P stores in markets like Cape Cod, where we have always been very successful.

#### Solutions for Growth

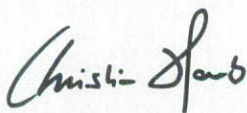
As consumer shopping and buying patterns change, so will A&P. With increased competition from warehouse clubs, discounters and category killers, we are presenting customers with one-stop shopping solutions by adding banks, pharmacies, expanded pet shops, baby care sections, reading centers, kitchen shops and Eight O'Clock coffee bars to answer their diverse and always changing needs.

As we work toward more solutions for growth in 1998, we are confident that A&P will continue to make progress on our long-term financial goals. We have an excellent group of associates becoming more dedicated to serving our customers. The expanded training opportunities we are offering them will help achieve our goal of becoming the supermarket of choice. Our management team is committed to achieving the goals and targets we have developed in our new plan. With solid market shares in core areas and a consistently improving store base, we are poised for future growth.

The change in the Company's leadership took place early in this 1998 fiscal year. Our management team and their plans are now in place to ensure that the strong foundation which has been established, will promote the growth that will produce superior returns for our shareholders in future years.



James Wood  
*Chairman of the Board*



Christian W.E. Haub  
*President and  
Chief Executive Officer*

#### Mission Statement

Our mission at The Great Atlantic & Pacific Tea Company is to become a customer-focused, leading food retailer in North America. We will become the "supermarket of choice" of an ever-growing number of customers in each market we serve, under each of the many valuable banners we operate. We will earn that position by achieving three compelling reasons for customers to choose our store as their store:

1. Providing superior customer service levels and an excellent attitude of service in clean, well-equipped, well-operated and well-maintained stores.
2. Providing great value by offering a wide variety of high quality products at competitive prices in fresh foods, private label and national brands.
3. Providing for every customer convenience and food preference by store, in every store.



We will develop our organization to be efficient, focused and dedicated to achieving all three compelling reasons every day, in every store. That requires us to have superior performing, highly trained, innovative and motivated employees today, and especially tomorrow.

As a result of our sustained effort to successfully achieve our mission, we will become the "supermarket of choice" for our customers to shop, for our employees to work, for our suppliers to partner with, and for our communities to be served. That will result in our Company delivering superior returns for our shareholders.



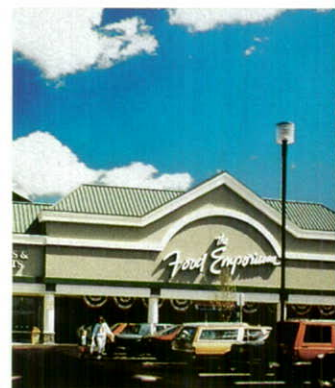
Solutions for the Future:

# New York: *More Quality Stores*



**Our produce and perishable departments keep the shopping experience fresh for our customers**

*Our stores entice shoppers with an abundance of delectable choices, from the Farmer's Market produce sections overflowing with the sweetest fruits and crispiest vegetables to bakeries that tempt customers with fragrant breads and beautiful cakes for every occasion. The Seafood Cove delights fish lovers with the freshest catch of the day, while our delis offer a full menu of prepared meals to serve at home.*



**Food Emporium**  
Fort Lee, New Jersey  
Opened April, 1997



three banners, each one offering something special for customers

*The Food Emporium*

*Superior Quality*



*Exceptional Variety*



*Total Value*

Keeping our stores fresh builds a stronger bond with our customers

U.S. Store Base

50%

new or remodeled  
in the last six years



*A&P*  
*Bayonne, New Jersey*  
*Opened June, 1997*

*Waldbaum's*  
*Stony Brook, New York*  
*Opened September, 1997*

*Shoppers in the New York Metropolitan area demand the best – and A&P gives it to them at A&P, Food Emporium and Waldbaum's.*

Our 148 A&P stores in Metro New York are delighting customers with aisle after aisle of outstanding products, including the freshest array of fruits, vegetables, deli and other perishables available anywhere. Banking, pharmacies and florists are all available under one roof in our new stores — redefining the neighborhood supermarket.

Specializing in selective foods, Food Emporium is meeting the needs of the metropolitan area's most discriminating customers with delicious gourmet foods, an exciting variety of imported products and carriage trade-style customer service. With 35 stores in Manhattan, and upscale neighborhoods in Westchester, Long Island, Northern New Jersey and Connecticut, Food Emporium is fast becoming a brand recognized for good taste — in every sense of the word.

Waldbaum's is a tradition in neighborhoods throughout New York City, Long Island and Westchester County. With specialty foods that cater to shoppers from a wide variety of ethnic origins, Waldbaum's is the place to shop for holiday fare and for ethnic products that are hard to find anywhere else.

A&P offers a unique solution to the competitive New York market, where clustering stores strengthens all of our marketing efforts and makes our entire operation more efficient. Our continuing significant investments in building new stores and making existing stores even better, bodes well for our future in Metro New York, where our volume buying and separate customer appeals makes our entire operation more effective.



# Canada: *The Level Playing Field*



**Food Basics lower cost structure draws more customers and replaces failing stores**

*The bottom line: new Food Basics stores are less expensive to operate. We pass the savings on to our customers, increasing our overall volume in the price-conscious market.*



**Air Miles Program increases shopper loyalty across the A&P and Dominion banners**

*Our shoppers are turning their weekly shopping trip into a rewarding experience. From a trip down the aisle to a vacation in the islands, our customers are shopping for more "air miles" specials.*



**Dominion offers superior quality and a wide selection of the finest merchandise**

*Toronto is a mosaic of cultures. That's why all of our delis, such as the one pictured above, are filled with the finest fresh meats from every ethnic tradition.*





*Superior Quality*



*Exceptional Variety*



*Total Value*

**Three banners, one goal:  
give the customers what  
they want most**



**Computer-based training  
reinforces customer focus**

*Our employees are taking advantage of  
the latest in computer-based training.  
Building a knowledgeable workforce  
is a crucial ingredient to enhancing  
customer service.*

*Providing customers with choice is A&P's solution in Ontario, Canada, where three strong banners — Food Basics, Dominion, and A&P — fulfill the needs of three different market segments.*

For Metro Toronto's upscale shoppers, 85 Dominion supermarkets offer a dazzling variety of items, including gourmet foods. Every Dominion store now features a distinctive Farmer's Market with an abundance of produce beautifully arranged to highlight the "just-picked" freshness of our fruits and vegetables. Selective urban and suburban shoppers appreciate this kind of detail, and continue to choose Dominion.

Outside the Toronto area, 94 A&P stores are serving customers with a plentiful array of products. Families enjoy the selection, quality and prices that A&P offers, and are proving loyal to our stores.

The low-price Food Basics banner serves Ontario's more cost-conscious shoppers. The 60 Food Basics stores (which include 52 franchisees) combine solid selection with very low pricing. Food Basics is proving so popular that we are continuing to seek new locations for this banner in 1998.

1996 was a turnaround year for our Canadian operations, and 1997 continued the market's solid growth to a 23% market share. We expect that 1998 will be equally positive, as we continue to add new stores, revitalize our existing store base and bring in new customers with heightened promotional and marketing campaigns.



Solutions for the Future:

# Michigan: *New Stores Make the Difference*



An Old Farmer Jack Store



The new Farmer Jack store in Highland Park, Michigan, opened November, 1997

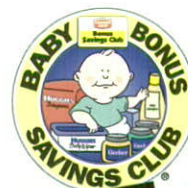
New stores drawing new customers and replacing outmoded stores

*At 60,000 square feet, our newest Farmer Jack store in Highland Park, Michigan (above), opened to great fanfare in November. The store's bright, clean, wide aisles are overflowing with high quality products - and customers are flocking in.*

Our expanded stores offer customers the products and services that match their lifestyle

*Help with the evening meal or with weekend parties are just a few of the services we offer.*

*Parents enrolled in the Farmer Jack Baby Club, for example, earn rewards each time they purchase baby supplies using our special club card.*







New stores opened in 1977  
averaged 36,000 sq. ft.

New stores opened in 1997  
averaged 54,000 sq. ft.

#### More Store

*Not just a store,  
but a solution for  
shoppers.*

**More square  
feet per store**  
allows us to  
create destination  
departments  
which offer a full  
range of products  
and services.

**Additional shops  
and conveniences**  
include banking,  
pharmacy, pet  
shops and  
liquor stores.

*Farmer Jack is fast becoming the hometown supermarket of choice in Michigan, providing a one-stop-shopping solution for today's busy customers. Farmer Jack's 101 stores in the Michigan area feature everything customers want. From delicious take-out meals that working parents love, to the highest quality meat, seafood and baked goods available, and the convenience of in-store pharmacies, pet shops and banking services, Farmer Jack makes shopping easier than ever before.*

Farmer Jack customers can also count on getting help when they need it from the Group's team of highly trained employees who take pride in keeping stores clean and shelves stocked with an exciting array of products. Farmer Jack stores are getting bigger and better – and employees are playing an important part in this success.

Thanks to a dedicated community relations program, customers are also learning that Farmer Jack is much more than just a supermarket: we're a neighborhood institution. Over the years, Farmer Jack has supported sports teams, charitable organizations and local improvement projects such as the River Rouge clean-up. In the most recent example, the November opening of the 60,000 square-foot Highland Park Superstore, built on the historic site of Henry Ford's first auto assembly plant, received high marks from community members, business leaders, local and state officials, and organizations such as the Detroit Institute of Arts. Farmer Jack honored the area's rich history by placing an original Model T in the plaza. Inside the store, a replica of "Detroit Industry," Diego Rivera's acclaimed 1932 mural, pays further tribute to the hard-working people of Detroit.

With the successful consolidation of all area A&P stores under the Farmer Jack name, and a stepped-up advertising and marketing program, shoppers are gaining a new appreciation of everything the store offers. These efforts have resulted in Farmer Jack's current 28% market share, and a continued development plan to assure market leadership.

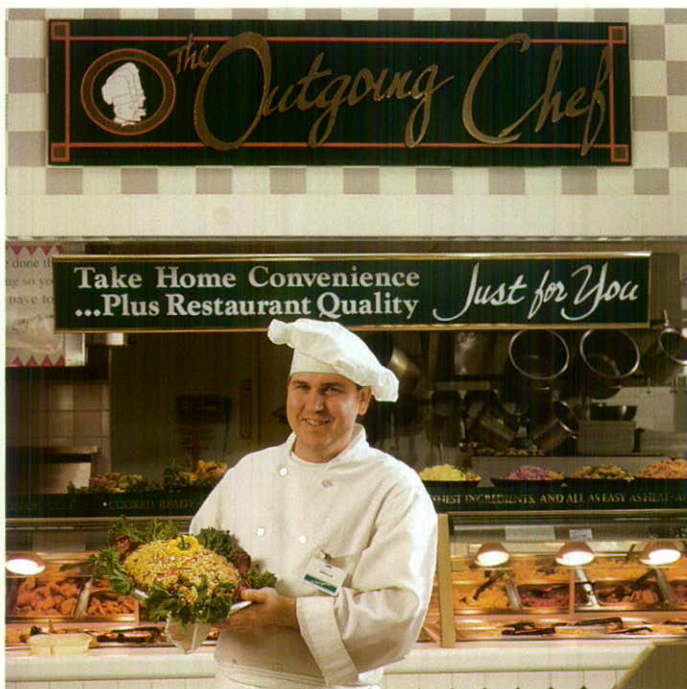


#### Working with the communities we serve, strengthening the future and saving our heritage.

*This replica of a famous  
Diego Rivera mural from the  
Detroit Institute of Arts  
(shown above) honors the  
hard-working people we serve in  
the Highland Park neighborhood.  
It's just one way we are reaching out  
to the shoppers in our communities.*



# Merchandising for the Millennium: *There's more to life than price...*



The Outgoing Chef provides  
Take Home Convenience for  
Consumers who appreciate  
Premium Quality Meals

*We know our customers lead  
hectic lives. That's why our  
"Outgoing Chef" prepares  
delicious, made-to-order meals  
that customers can heat up and  
have on the table in minutes.  
It's quality and convenience  
to go.*

Stores within the store capture the full range of our private label products and selected categories for discerning consumers

*Whether it's the kitchen shop, the pet shop, or our health and beauty care department, customers love our stores-within-a-store. They also love the great quality and value they get with our private label products, including America's Choice and Master Choice. The Eight O'Clock Coffee Shop (below), now in selected stores, offers customers a chance to enjoy one of our best-known brands.*





*A&P is keeping up with the ever-quicken-  
ing pace of our customers' lives. With convenience  
becoming increasingly important, A&P  
offers a "one-stop shopping" solution for the  
communities we serve.*

Today, A&P features greater choices in prepared foods, so that busy customers can purchase healthy, ready-made meals for their families. More and more of our stores now feature personal care departments and on-site services such as banking and pharmacies that make the weekly shopping trip easier. At the same time, A&P's long-standing reputation for quality continues to grow. Our perishables departments are getting bigger and better, with more of the freshest dairy, produce, deli, bakery, seafood and meats for which we are known.

What does the future hold? New stores, new services and new departments are one important part of the answer. Satisfied customers who know that A&P will continue to recognize and meet their changing needs is the other.

**Still, we understand  
that value is paramount for  
other shoppers.**

*Club Pack answers the needs  
of customers who put value  
first. Our Club Pack aisle  
offers a wide array of choices  
purchased in bulk at  
highly-competitive prices.*



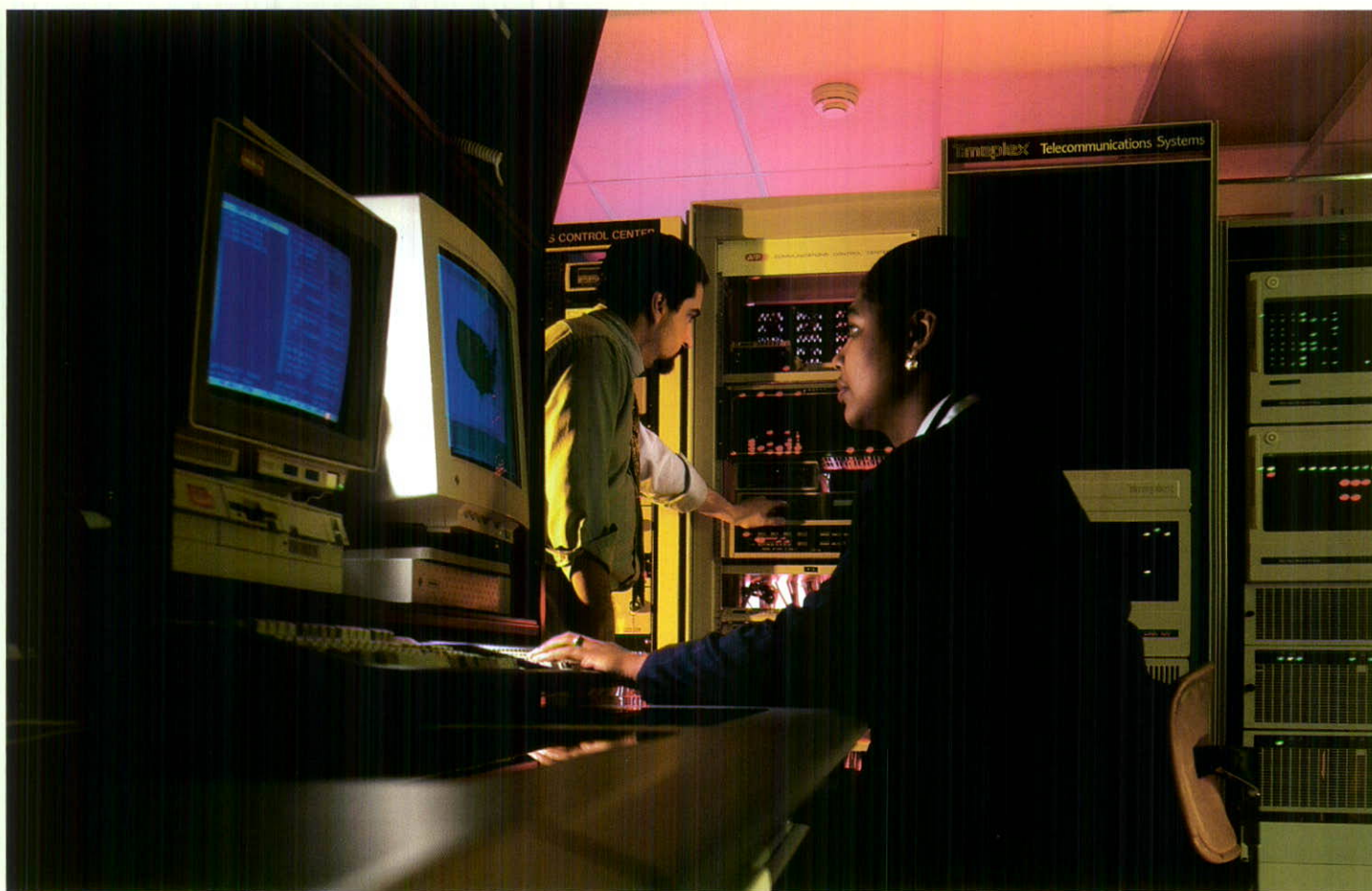
solutions



Solutions for the Future:

# Strengthening Our Future

## *Strategies for Growth*



Our computerized systems link our buying office directly with stores to ensure variety and freshness.

*With the latest technology in place, we are improving every aspect of store management — including buying, inventory control, category management, and employee scheduling.*

*The result is better quality, variety and service.*







Communicating our improvements — our advertising messages feature our card programs, new stores, and freshness standards to shoppers.

We tailor our advertising messages to each of our markets. For example, the Metro New York Group is introducing a TV campaign with a new spokesperson in 1998 to emphasize: new stores, perishables, service, and value.



A&P is poised to build on its current position with a solid strategy for success. It starts with our employees, who we believe can and should be the best in the business. To meet this objective, we are offering improved training programs in customer service and technology. The result is a higher level of capability and commitment.

A&P's Frequent Shopper Program is drawing new customers and helping us stay in touch with their needs. The Frequent Shopper card rewards customers with discounts and other benefits.

It also helps A&P track customer preferences, spending habits, and trends, improve marketing efforts, and better target direct mail. By analyzing consumer traffic patterns, these cards also help A&P to staff and run each store more efficiently.

These efforts are making a difference. A&P is winning customer loyalty thanks to a dynamic combination of quality, convenience, location, and choice.

We value our employees and as they grow with experience, so will A&P.

Our people are being trained to be customer-focused and motivated towards achieving our goal of becoming the supermarket of choice.

solutions

for growth



## OPERATING RESULTS

### ***Fiscal 1997 Compared with 1996***

Sales for fiscal 1997 were \$10,262 million, a net increase of \$173 million or 1.7% when compared to fiscal 1996 sales of \$10,089 million. U.S. sales increased \$62 million or 0.8% compared to fiscal 1996. U.S. same store sales, which include replacement stores ("same store sales" referred to herein includes replacement stores), were 2.0% below the prior year. In Canada, sales increased \$111 million or 6.1% from fiscal 1996 to \$1,918 million. Canada same store sales were up 0.6% from the prior year.

Total Company same store sales for fiscal 1997 decreased 1.6% from the prior year. Average weekly sales per supermarket were approximately \$199,400 in fiscal 1997 versus \$195,200 in fiscal 1996 for a 2.2% increase. During fiscal 1997, the Company opened 33 new supermarkets, 3 new liquor stores and 4 new Food Basics franchised stores, remodeled or expanded 45 stores, and closed 74 stores, of which 11 in the Carolina market were sold.

The sales increase of \$173 million from last year was mainly the result of new store openings and an extra week of sales in fiscal 1997. The Company opened 36 stores, excluding 32 stores that replaced 32 older, outmoded stores, since the beginning of fiscal 1996 which increased sales by approximately \$262 million or 2.6% in fiscal 1997. In addition, wholesale sales to the Food Basics franchised stores increased \$135 million or 66% to \$340 million for fiscal 1997, which increased total Company sales by 1.3%. In fiscal 1997, sales increased \$174 million or 1.7% as a result of an extra week sales during this 53 week year compared to a 52 week year in fiscal 1996. These increases were partially offset by the closure of 114 stores, excluding replacement stores, since the beginning of fiscal 1996, of which 11 were sold in the Carolina market reducing total sales by approximately \$218 million or 2.1% in fiscal 1997. The store closures include 24 stores that were subsequently converted to Food Basics franchised stores. The 1.6% decrease in same store sales resulted in a sales decrease of \$153 million in fiscal 1997, while a lower Canadian exchange rate resulted in a sales decrease of \$45 million in fiscal 1997.

Gross margin as a percent of sales decreased 0.4% to 28.6% from 29.0% for the prior year resulting primarily from the increase of the lower margin wholesale sales from 2.0% to 3.3% of total Company sales in fiscal 1997, partially offset by an

increase in the retail supermarket margin rate in the U.S. The gross margin percentage in the retail stores remained flat from the prior year. The gross margin dollar increase of \$13 million is primarily the result of an increase in sales volume which had an impact of increasing margin by \$66 million, partially offset by a decrease in gross margin rates of \$40 million and a lower Canadian exchange rate which decreased margin by \$13 million. The U.S. gross margin increased \$24 million principally as a result of an increase in sales volume which had an impact of increasing margin by \$19 million and an increase in gross margin rates of \$5 million. The Canadian operations gross margin decreased \$11 million which was primarily the result of the wholesale sales increase from the prior year.

Store operating, general and administrative expense of \$2,780 million in fiscal 1997 increased by approximately \$27 million from fiscal 1996. As a percent of sales, store operating, general and administrative expense for fiscal 1997 decreased to 27.1% from 27.3% for the prior year. U.S. expenses increased \$36 million, principally as a result of increased store labor and occupancy costs on the new superstores opened in fiscal 1997. In addition, store closing costs increased by \$8 million which was offset by gains on sales of real estate of \$11 million. Canadian expenses decreased \$9 million, principally as a result of reduced store labor and occupancy costs due to converting 24 stores to Food Basics franchised stores.

Interest expense increased \$7 million from the previous year, primarily due to an increase in average debt of approximately \$95 million. The increase in debt is mainly the result of the Company issuing \$300 million 10 year notes in April 1997 to refinance 10 year notes that were becoming due in January 1998. The debt outstanding in April 1997 subsequent to the issuance of the \$300 million 10 year notes was approximately \$862 million, which was reduced to \$712 million at February 28, 1998.

Interest income increased \$3 million from the previous year, primarily due to interest income on equipment leases relating to the Food Basics franchise business and higher interest income on short-term investments. The interest income on short-term investments was mainly the result of the Company investing a portion of the proceeds from the \$300 million 10 year notes in April 1997 prior to the use of the cash to refinance the bonds due in January 1998.



Income before taxes and extraordinary item for fiscal 1997 was \$83 million as compared to \$101 million in fiscal 1996 for a decrease of \$18 million or 18%. Income before taxes for U.S. operations decreased \$23 million from \$68 million in fiscal 1996 to \$45 million in fiscal 1997. The U.S. decrease was partially offset by an increase in Canadian operations income before taxes of \$5 million to \$37 million in fiscal 1997 from \$32 million in fiscal 1996.

The effective tax rate for fiscal 1997 was 23.3% as compared to an effective tax rate of 27.4% in fiscal 1996. During fiscal 1997, since the Canadian operations generated pretax earnings, the Company reversed approximately \$17 million of the valuation allowance, which was an increase of \$3 million from the fiscal 1996 reversal of \$14 million. Accordingly, the decrease in the effective tax rate is mainly attributable to the change in the Canadian income tax valuation allowance. The Company is reversing the income tax valuation allowance to the extent that its Canadian operations generate taxable income.

Although Canada generated pretax earnings in fiscal 1997 of \$37 million and \$32 million in fiscal 1996, the Company was unable to conclude that the Canadian deferred tax assets were more likely than not to be realized. This conclusion was based in part on Management's assessment of the competitive Canadian marketplace and the level of the Canadian earnings. Accordingly, at February 28, 1998 the Company is continuing to fully reserve its Canadian net deferred tax asset. The valuation allowance will be adjusted when and if, in the opinion of Management, significant positive evidence exists which indicates that it is more likely than not that the Company will be able to realize the Canadian net deferred tax asset. The positive evidence that Management believes is necessary in order to reverse some or all of the Canadian deferred tax asset valuation allowance is a trend in earnings to a level which would allow Management to conclude that it is more likely than not that a portion or all of the deferred tax assets would be realized. The Canadian pretax income for financial statement purposes are higher than the taxable income for tax purposes due to certain differences between the financial statement and income tax treatment of certain items. This is of further significance since the largest portion of the Canadian deferred tax asset relates to net operating loss carryforwards which expire between fiscal 1999 and fiscal 2002 (see "Income Taxes" footnote for further discussion).

In the second quarter of fiscal 1997, the Company recorded an extraordinary charge of \$0.5 million, net of a tax benefit of \$0.4 million relating to the early extinguishment of debt which amounted to \$0.01 per share - basic and diluted. The Company retired at a premium approximately \$20 million in mortgages with a weighted average interest rate of 9.4%.

Net income for fiscal 1997 after recording an extraordinary charge of \$0.01 per share - basic and diluted, was \$63 million or \$1.65 per share - basic and diluted, as compared to \$73 million or \$1.91 per share - basic and diluted, for fiscal 1996. The decrease in net income is the result of higher store operating, general and administrative expenses of \$27 million, partially offset by higher gross margins of \$13 million coupled with a lower effective income tax rate.

#### ***Fiscal 1996 Compared with 1995***

Sales for fiscal 1996 were \$10,089 million, a net decrease of \$12 million or 0.1% when compared to fiscal 1995 sales of \$10,101 million. U.S. sales decreased \$83 million or 1.0% compared to fiscal 1995. U.S. same store sales were down 0.7% from the prior year. In Canada, sales increased \$71 million or 4.1% from fiscal 1995 to \$1,807 million. Canada same store sales were up 0.5% from the prior year.

Total Company same store sales for fiscal 1996 decreased 0.5% from the prior year. Average weekly sales per supermarket were approximately \$195,200 in fiscal 1996 versus \$183,300 in fiscal 1995 for a 6.5% increase. During fiscal 1996, the Company opened 27 new supermarkets and 3 new liquor stores, remodeled or expanded 72 stores, and closed 71 stores, of which 23 were converted to Food Basics franchised stores in Canada.

The sales decrease of \$12 million from last year was mainly the result of store closings. The Company closed 171 stores, excluding replacement stores, since the beginning of fiscal 1995 which reduced comparative sales by approximately \$443 million or 4.4% in fiscal 1996. The store closures include 41 stores that were subsequently converted to Food Basics franchised stores. The lost sales of the store closures were offset by the opening of 35 new stores, excluding 25 stores that replaced 27 older, outmoded stores, since the beginning of fiscal 1995 which increased sales by approximately \$276 million or 2.7% in fiscal 1996. In addition, the opening and conversion of 42 Food Basics franchised stores in fiscal 1996 increased wholesale sales to the Franchisees by \$199 million to sales of \$205 million in fiscal 1996, from sales of only \$6 million in fiscal 1995.



Gross margin as a percent of sales decreased 0.1% to 29.0% for the current year from 29.1% for the prior year resulting primarily from lower margins on wholesale sales to the Food Basics franchised stores, partially offset by an increase in the retail supermarket margin in both the U.S. and Canada. The gross margin dollar decrease of \$14 million is primarily the result of a decrease in gross margin rates of \$10 million, a decrease in sales volume which had an impact of decreasing margin by \$6 million, partially offset by a higher Canadian exchange rate resulting in an increase of \$2 million. The U.S. gross margin increased \$16 million principally as a result of increased gross margin rates of \$40 million, partially offset by a decrease in sales volume which had an impact of decreasing margin by \$24 million. In Canada, gross margin decreased \$30 million, primarily resulting from the effect of a decrease in gross margin rates of \$50 million, partially offset by sales volume increases which impacted margins by \$18 million, and a higher Canadian exchange rate resulting in an increase of \$2 million.

Store operating, general and administrative expense of \$2,752 million in fiscal 1996 declined by approximately \$31 million from fiscal 1995. As a percent of sales, store operating, general and administrative expense for fiscal 1996 decreased to 27.3% from 27.6% for the prior year. U.S. expenses increased \$19 million, principally as a result of increased store labor and rental costs on the new superstores opened in fiscal 1996. Canadian expenses decreased \$50 million, principally as a result of reduced store labor and occupancy costs as a result of converting 41 stores to Food Basics franchised stores.

Interest expense increased \$0.1 million from the previous year, primarily due to increased average borrowings in the U.S. partially offset by lower average interest rates.

Interest income increased \$2 million from the previous year, primarily due to interest income on equipment leases and inventory notes relating to the Food Basics franchise business.

Income before taxes for fiscal 1996 was \$101 million as compared to \$81 million in fiscal 1995 for an increase of \$20 million or 24%. Income before taxes increased due to improvements in the results of the Canadian operations of \$24 million from \$8 million in fiscal 1995 to \$32 million in fiscal 1996. The Canadian increase was partially offset by a decrease in U.S. income before taxes from \$73 million in fiscal 1995 to \$69 million in fiscal 1996.

The effective tax rate for fiscal 1996 was 27.4% as compared to an effective tax rate of 29.4% in fiscal 1995. Included in the fiscal 1995 tax provision is a \$6.5 million or \$0.17 per share - basic and diluted, credit relating to a refund of previously paid taxes in Canada. Excluding the \$6.5 million credit, the fiscal 1995 income tax provision would have been \$30.4 million resulting in an effective tax rate of 37.4%. The decrease in the effective tax rate, after giving effect to this credit is mainly attributable to the change in the Canadian income tax valuation allowance. The Company is reversing the income tax valuation allowance to the extent that its Canadian operations generate taxable income.

During fiscal 1996, since the Canadian operations generated pretax earnings, the Company reversed approximately \$14 million of the valuation allowance. Although Canada generated pretax earnings in fiscal 1996 of \$32 million and \$8 million in fiscal 1995, the Company was unable to conclude that the Canadian deferred tax assets were more likely than not to be realized. Accordingly, at February 22, 1997 the Company continued to fully reserve its Canadian net deferred tax assets. The valuation allowance will be adjusted when and if, in the opinion of Management, significant positive evidence exists which indicates that it is more likely than not that the Company will be able to realize the Canadian deferred tax assets (see "Income Taxes" footnote for further discussion).

Net income for fiscal 1996 was \$73 million or \$1.91 per share - basic and diluted as compared to \$57 million or \$1.50 per share - basic and diluted for fiscal 1995. Excluding the \$6.5 million or \$0.17 per share - basic and diluted Canadian tax refund, fiscal 1995 net income would have been \$51 million or \$1.33 per share - basic and diluted. Accordingly, excluding the effect of such refund, net income increased \$22 million or \$0.58 per share - basic and diluted. The increase in net income is the result of lower store operating, general and administrative expenses of \$31 million, coupled with a lower effective income tax rate, partially offset by lower gross margins of \$14 million.



## LIQUIDITY AND CAPITAL RESOURCES

The Company ended the 1997 fiscal year with working capital of \$262 million compared to \$215 million and \$191 million at February 22, 1997 and February 24, 1996, respectively. The Company had cash and short-term investments aggregating \$71 million at the end of fiscal 1997 compared to \$99 million and \$100 million at the end of fiscal 1996 and 1995, respectively.

On June 10, 1997, the Company executed an unsecured five year \$465 million U.S. credit agreement and a five year C\$50 million Canadian credit agreement (the "1997 Credit Agreement") with a syndicate of banks, enabling it to borrow funds on a revolving basis sufficient to refinance short-term borrowings. This 1997 Credit Agreement replaced a previous five year \$400 million U.S. revolving credit agreement and a C\$100 million revolving credit agreement dated December 12, 1995. The 1997 Credit Agreement resulted in the Company obtaining a lower cost of borrowing, reduced facility fees, and extended the maturity to June 2002. The Company pays a facility fee ranging from 3/16% to 1/2% per annum on the total commitment of the U.S. and Canadian revolving credit facilities. Borrowings under the U.S. revolving credit agreement were \$90 million and \$95 million at February 28, 1998 and February 22, 1997, respectively. The Canadian subsidiary had no outstanding borrowings at February 28, 1998 and \$59 million at February 22, 1997. As of February 28, 1998, the Company had available \$375 million under its U.S. credit agreement and C\$50 million (U.S. \$35 million at February 28, 1998) under the Canadian credit agreement. As of February 22, 1997, the Company had available \$305 million under its U.S. revolver and C\$19 million (U.S. \$14 million at February 22, 1997) under the Canadian credit agreement. In addition, the U.S. has uncommitted lines of credit with various banks amounting to \$149 million and \$145 million as of February 28, 1998 and February 22, 1997, respectively. Borrowings under these uncommitted lines of credit amounted to \$38 million and \$52 million as of February 28, 1998 and February 22, 1997, respectively.

As of February 28, 1998, the Company had outstanding a total of \$575 million of unsecured, non-callable public debt securities in the form of \$75 million 7.78% Notes due November 1, 2000, \$200 million 7.70% Notes due January 15, 2004 and \$300 million 7.75% Notes due April 15, 2007. As of February 28, 1998, the Company had \$410 million available under the 1997 Credit Agreement and \$111 million in uncommitted lines of credit.

On April 15, 1997, the Company issued \$300 million 7.75% 10 year Notes due April 15, 2007. The Company used the net proceeds to reduce bank borrowings under the U.S. and Canadian revolving credit facilities, prepay other indebtedness and for general corporate purposes. The Company borrowed funds available under the U.S. credit facility to repay at maturity, indebtedness owing in respect of the Company's 9 1/8% Notes due January 15, 1998.

On June 12, 1997, the Company offered to exchange its 7.75% 10 year Notes due April 15, 2007, which were registered under the Securities Act, for outstanding 7.75% 10 year Notes due April 15, 2007, which had not been so registered. The exchange offer expired on July 10, 1997 with all outstanding unregistered 10 year Notes exchanged for registered 10 year Notes.

On October 17, 1995, the Company's Canadian subsidiary, The Great Atlantic & Pacific Company of Canada, Ltd. ("A&P Canada"), issued U.S. \$75 million of unsecured, non-callable 7.78% Notes due November 1, 2000 guaranteed by the Company. The net proceeds from the issuance of these Notes were used to repay indebtedness under the Canadian subsidiary's revolving credit facility. In conjunction with the issuance of the U.S. \$75 million Notes, A&P Canada entered into a five year cross-currency swap agreement expiring November 1, 2000. The cross-currency swap was executed for protection against the effect of a decrease in Canadian exchange rates on both the semi-annual interest payments and the final principal payment due to the Company's U.S. bondholders. The cross-currency swap enables the Company to pay in Canadian dollars a fixed rate of interest of 9.23% on a notional amount of C\$100 million for the \$75 million 7.78% Notes denominated in U.S. dollars. The cost of the cross-currency swap of 1.45% is charged to interest expense. The Company records an asset or liability to the extent that an eventual transaction gain or loss is expected to be recorded upon the settlement of the notional amount of the underlying debt. Accordingly, the Company has recorded in other assets the receivable due from the counterparty amounting to approximately \$4.5 million and \$1.4 million as of February 28, 1998 and February 22, 1997, respectively. The fair value of the cross-currency swap was favorable to the Company by \$1 million as of February 28, 1998 and unfavorable to the Company by \$5.4 million as of February 22, 1997. The Company is exposed to credit losses in the event of nonperformance by the counterparty to its currency swap. However, the Company anticipates that the counterparty will be able to fully satisfy its obligations under the contracts.



On April 15, 1997, A&P Canada entered into an interest rate swap agreement with a notional amount of C\$100 million where the Company receives a fixed rate of interest and pays a variable rate of interest. The fair value of the interest rate swap was favorable to the Company by \$1.4 million as of February 28, 1998. This interest rate swap agreement has the same counterparty as the cross-currency swap agreement.

The Company's loan agreements and certain of its notes contain various financial covenants which require, among other things, minimum net worth and maximum levels of indebtedness and lease commitments. The Company was in compliance with all such financial covenants as of February 28, 1998, and believes that it will continue to be in compliance.

During fiscal 1997, the Company funded its capital expenditures, debt repayments and cash dividends through internally generated funds combined with proceeds from bank borrowings.

U.S. bank borrowings were \$128 million at February 28, 1998 as compared to \$147 million at February 22, 1997. U.S. bank borrowings during fiscal 1997 were at an average interest rate of 6.0% compared to 5.8% in fiscal 1996.

Canada had no bank borrowings at February 28, 1998 and \$59 million at February 22, 1997. Canadian bank and commercial paper borrowings during fiscal 1996 were at an average interest rate of 5.3%.

Pursuant to a Shelf Registration Statement dated January 23, 1998, the Company may offer up to \$500 million of debt and equity securities at terms determined by market conditions at the time of sale.

Capital expenditures totaled \$268 million during fiscal 1997, which included 33 new supermarkets, 3 new liquor stores, 4 new Food Basics franchised stores, and 45 remodels and enlargements.

For fiscal 1998, the Company has planned capital expenditures of approximately \$300 million and plans to open 45 new supermarkets and remodel or expand 80 stores. It has been the Company's experience over the past several years that it typically takes 12 to 15 months after opening for a new store to recoup its opening costs and become profitable

thereafter. Risks inherent in retail real estate investments are primarily associated with competitive pressures in the marketplace. Beginning in fiscal 1998 through fiscal 2000, the Company intends to improve the use of technology to improve customer service, store operations, warehousing/distribution and merchandising and to intensify advertising and promotions. The Company currently expects to close approximately 60 stores in fiscal year 1998.

The Company plans to open approximately 50 new supermarkets in fiscal 1999 and approximately 55 new supermarkets per year thereafter for several years, with an attendant increase in square footage of approximately 3% per year, and to remodel an average of 50 stores per year. The Company's concentration will be on larger stores in the 50,000 to 65,000 square foot range. Costs of each project will vary significantly based upon size, marketing format, geographic area and development involvement required from the Company. The planned costs of these projects approximate \$4 million for a new store and \$1 million for a remodel or enlargement. Traditionally, the Company leases real estate and expends capital on leasehold improvements and store fixtures and fittings. Consistent with the Company's history, most new store activity will be directed into those areas where the Company achieves its best profitability. Remodeling and enlargement programs are normally undertaken based upon competitive opportunities and usually involve updating a store to a more modern and competitive format.

The fiscal 1997 quarterly dividend was \$0.10 per share and amounted to \$15.3 million. The Company expects to maintain the same dividend amount for fiscal 1998.

At fiscal year end, the Company's existing senior debt rating was Baa3 with Moody's Investors Service and BBB- with Standard & Poor's Ratings Group. A change in either of these ratings could affect the availability and cost of financing.

The Company's current cash resources, together with cash generated from operations, will be sufficient for the Company's 1998 capital expenditure program, mandatory scheduled debt repayments and dividend payments throughout fiscal 1998.



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## MARKET RISK

Market risk represents the risk of loss that may impact the consolidated financial position, results of operations or cash flows of the Company. The Company is exposed to market risk in the areas of interest rates and foreign currency exchange rates.

### *Interest Rates*

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's debt obligations. The Company has no cash flow exposure due to rate changes on its \$500 million in notes. However, the Company does have cash flow exposure on its committed and uncommitted bank lines of credit due to its variable LIBOR pricing. In addition, during 1997 the Company entered into an interest rate swap agreement whereby the Company receives a fixed interest rate while paying a variable rate of interest on the \$75 million Canadian notes. Accordingly, a 1% change in LIBOR will result in interest expense fluctuating approximately \$2.5 million.

### *Foreign Exchange Risk*

The Company is exposed to foreign exchange risk to the extent of adverse fluctuations in the Canadian dollar. Based upon historical Canadian currency movement, the Company does not believe that reasonably possible near-term changes in the Canadian currency will result in a material effect on future earnings, financial position or cash flows of the Company.

The Company entered into a five year cross-currency swap agreement to hedge five year notes in Canada that are denominated in U.S. dollars. The Company does not have any currency risk regarding the Canadian five year notes. The Company is exposed to currency risk in the event of default by the counterparty. Such default is remote as the counterparty is a widely recognized investment banker.

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## YEAR 2000 COMPLIANCE

The year 2000 issue is the result of computer programs that were written using two digits rather than four to define the applicable year. Accordingly, computer programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. To the extent that the Company's software applications contain source code that is unable to appropriately interpret the upcoming calendar year 2000 and beyond, some level of modification or replacement of such applications will be necessary to avoid the possibility of system failures and the temporary inability to process transactions or engage in other normal business activities.

The Company has implemented a formal plan to address the year 2000 issue which includes assessing the extent of

affected software and developing procedures to resolve the potential problems associated with that software. In addition, the Company is communicating with its major vendors to determine the extent to which the Company might be affected by their year 2000 compliance issues.

Based on current information, costs of addressing potential problems are not expected to have a material adverse impact on the Company's financial position, results of operations or cash flows in future periods. However, if the Company, or its vendors are unable to resolve such processing issues in a timely manner, it could result in a material financial risk. Accordingly, the Company has allocated the resources it believes are necessary to resolve all significant year 2000 issues in a timely manner.

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## IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130 "Reporting Comprehensive Income" ("SFAS 130") and SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). SFAS 130 relates to the change in the equity of a business during a reporting period from transactions of the business. The Company currently intends to adopt this new accounting standard effective in the first quarter of fiscal 1998. The expected impact in the adoption of SFAS 130 is not readily determinable as the impact is predicated on the future changes in the Canadian exchange rate. SFAS 131 supersedes SFAS No. 14 "Financial Reporting for Segments of a Business Enterprise". SFAS 131 provides for the disclosure of financial information disaggregated by the way management organizes the segments of the enterprise for making operating decisions. The Company is currently assessing the extent of disclosures that will be required by SFAS 131 and will adopt this statement in fiscal 1998.

In February 1998, the FASB issued SFAS No. 132 "Employer's Disclosures about Pensions and Other Postretirement Benefits" ("SFAS 132"). SFAS 132 standardizes the disclosure requirements for pensions and other postretirement benefits. It does not address the accounting for such benefits. SFAS 132 is effective for fiscal years beginning after December 31, 1997 and requires restatement of disclosures for all prior periods presented. The Company will adopt SFAS 132 in fiscal 1998 and believes it will impact the financial statements to the extent that it is necessary to provide additional disclosure about the Company's pensions and other postretirement benefits.



# Statements of Consolidated Operations

The Great Atlantic & Pacific Tea Company, Inc.

(Dollars in thousands, except per share amounts)	Fiscal 1997 (53 weeks)	Fiscal 1996 (52 weeks)	Fiscal 1995 (52 weeks)
Sales	\$10,262,243	\$10,089,014	\$10,101,356
Cost of merchandise sold	(7,327,365)	(7,167,315)	(7,166,119)
Gross margin	2,934,878	2,921,699	2,935,237
Store operating, general and administrative expense	(2,779,619)	(2,752,396)	(2,783,503)
Income from operations	155,259	169,303	151,734
Interest expense	(80,152)	(73,208)	(73,143)
Interest income	7,793	4,496	2,501
Income before income taxes and extraordinary item	82,900	100,591	81,092
Provision for income taxes	(19,314)	(27,559)	(23,868)
Income before extraordinary item	63,586	73,032	57,224
Extraordinary loss on early extinguishment of debt (net of income tax benefit of \$394)	(544)	—	—
Net income	\$ 63,042	\$ 73,032	\$ 57,224
Basic earnings (loss) per share:			
Income before extraordinary item	\$ 1.66	\$ 1.91	\$ 1.50
Extraordinary loss on early extinguishment of debt	(0.01)	—	—
Net income per share - basic	\$ 1.65	\$ 1.91	\$ 1.50
Diluted earnings (loss) per share:			
Income before extraordinary item	\$ 1.66	\$ 1.91	\$ 1.50
Extraordinary loss on early extinguishment of debt	(0.01)	—	—
Net income per share - diluted	\$ 1.65	\$ 1.91	\$ 1.50

See Notes to Consolidated Financial Statements.



# Statements of Consolidated Shareholders' Equity

The Great Atlantic & Pacific Tea Company, Inc.

(Dollars in thousands, except share amounts)

	Fiscal 1997	Fiscal 1996	Fiscal 1995
<i>Common stock:</i>			
Shares:			
Issued and outstanding at beginning of year	38,247,716	38,220,333	38,220,333
Stock options exercised	5,250	27,383	—
Issued and outstanding at end of year	38,252,966	38,247,716	38,220,333
Balance at beginning of year	\$ 38,247	\$ 38,220	\$ 38,220
Stock options exercised	6	27	—
Balance at end of year	\$ 38,253	\$ 38,247	\$ 38,220
<i>Capital surplus:</i>			
Balance at beginning of year	\$ 453,751	\$ 453,121	\$ 453,121
Stock options exercised	143	630	—
Balance at end of year	\$ 453,894	\$ 453,751	\$ 453,121
<i>Cumulative translation adjustment:</i>			
Balance at beginning of year	\$ (49,694)	\$ (50,936)	\$ (49,227)
Exchange adjustment	(5,121)	1,242	(1,709)
Balance at end of year	\$ (54,815)	\$ (49,694)	\$ (50,936)
<i>Minimum pension liability adjustment:</i>			
Balance at beginning of year	\$ —	\$ —	\$ —
Minimum pension liability adjustment	(6,210)	—	—
Balance at end of year	\$ (6,210)	\$ —	\$ —
<i>Retained earnings:</i>			
Balance at beginning of year	\$ 447,768	\$ 382,380	\$ 332,800
Net income	63,042	73,032	57,224
Cash dividends	(15,300)	(7,644)	(7,644)
Balance at end of year	\$ 495,510	\$ 447,768	\$ 382,380



# Consolidated Balance Sheets

The Great Atlantic & Pacific Tea Company, Inc.

(Dollars in thousands)	February 28, 1998	February 22, 1997
<b>A S S E T S</b>		
<i>Current assets:</i>		
Cash and short-term investments	\$ 70,937	\$ 98,830
Accounts receivable	227,703	213,888
Inventories	882,229	881,288
Prepaid expenses and other assets	36,358	37,373
Total current assets	1,217,227	1,231,379
<i>Property:</i>		
Land	138,139	128,779
Buildings	368,201	343,076
Equipment and leasehold improvements	2,122,860	2,118,808
Total-at cost	2,629,200	2,590,663
Less accumulated depreciation and amortization	(1,122,381)	(1,104,159)
	1,506,819	1,486,504
Property leased under capital leases	90,058	103,474
Property-net	1,596,877	1,589,978
Other assets	181,149	181,315
	<u>\$2,995,253</u>	<u>\$ 3,002,672</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<i>Current liabilities:</i>		
Current portion of long-term debt	\$ 16,824	\$ 18,290
Current portion of obligations under capital leases	12,293	12,708
Accounts payable	441,149	468,808
Book overdrafts	151,846	182,305
Accrued salaries, wages and benefits	146,064	146,737
Accrued taxes	57,856	52,269
Other accruals	129,098	134,888
Total current liabilities	955,130	1,016,005
Long-term debt	695,292	701,609
Obligations under capital leases	120,980	137,886
Deferred income taxes	120,618	113,188
Other non-current liabilities	176,601	143,912
Commitments and contingencies		
<i>Shareholders' equity:</i>		
Preferred stock-no par value; authorized- 3,000,000 shares; issued-none		
Common stock-\$1 par value; authorized - 80,000,000 shares; issued and outstanding 38,252,966 and 38,247,716 shares, respectively	38,253	38,247
Capital surplus	453,894	453,751
Cumulative translation adjustment	(54,815)	(49,694)
Minimum pension liability adjustment	(6,210)	—
Retained earnings	495,510	447,768
Total shareholders' equity	926,632	890,072
	<u>\$2,995,253</u>	<u>\$ 3,002,672</u>

See Notes to Consolidated Financial Statements.



# Statements of Consolidated Cash Flows

The Great Atlantic & Pacific Tea Company, Inc.

(Dollars in thousands)	Fiscal 1997	Fiscal 1996	Fiscal 1995
<i>Cash Flows From Operating Activities:</i>			
Net income	\$ 63,042	\$ 73,032	\$ 57,224
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	234,236	230,748	225,449
Deferred income tax provision (benefit) on income			
before extraordinary item	11,425	(1,067)	9,496
(Gain) loss on disposal of owned property, net	(11,363)	1,338	(3,177)
(Increase) decrease in receivables	(14,116)	(5,615)	556
Increase in inventories	(6,090)	(53,672)	(13,103)
(Increase) decrease in prepaid expenses and other current assets	(2,630)	6,401	(573)
Increase in other assets	(1,435)	(26,753)	(12,066)
Increase (decrease) in accounts payable	(24,542)	15,950	3,944
Increase (decrease) in accrued expenses	8,594	(2,657)	(4,251)
Increase (decrease) in store closing reserves	6,104	(8,600)	(18,240)
Increase (decrease) in other accruals and other liabilities	14,052	(13,307)	16,518
Other operating activities, net	(1,050)	271	193
Net cash provided by operating activities	276,227	216,069	261,970
<i>Cash Flows From Investing Activities:</i>			
Expenditures for property	(267,623)	(296,878)	(236,139)
Proceeds from disposal of property	31,783	19,408	34,576
Net cash used in investing activities	(235,840)	(277,470)	(201,563)
<i>Cash Flows From Financing Activities:</i>			
Changes in short-term debt	(34,500)	37,000	13,000
Proceeds under revolving lines of credit	947,148	459,312	1,182,183
Payments on revolving lines of credit	(991,296)	(439,591)	(1,329,409)
Proceeds from long-term borrowings	304,213	4,978	75,000
Payments on long-term borrowings	(233,348)	(6,155)	(4,005)
Principal payments on capital leases	(13,711)	(13,166)	(17,953)
Increase (decrease) in bank overdrafts	(28,145)	24,901	(1,075)
Deferred financing fees	(2,471)	—	—
Proceeds from stock options exercised	149	657	—
Cash dividends	(15,300)	(7,644)	(7,644)
Net cash provided by (used in) financing activities	(67,261)	60,292	(89,903)
Effect of exchange rate changes on cash and short-term investments	(1,019)	167	338
Net Decrease in Cash and Short-term Investments	(27,893)	(942)	(29,158)
Cash and Short-term Investments at Beginning of Year	98,830	99,772	128,930
Cash and Short-term Investments at End of Year	\$ 70,937	\$ 98,830	\$ 99,772

See Notes to Consolidated Financial Statements.



## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Basis of Presentation*

The consolidated financial statements include the accounts of the Company and all majority-owned subsidiaries. The Company operates retail supermarkets in the United States and Canada. The U.S. operations are mainly in the Eastern part of the U.S. and certain parts of the Midwest. See the following footnotes for additional information on the Canadian Operations: Operations in Geographic Areas, Food Basics Franchise Business, Income Taxes and Retirement Plans and Benefits.

### *Revenue Recognition*

Retail revenue is recognized at point of sale while wholesale revenue is recognized when goods are shipped.

### *Fiscal Year*

The Company's fiscal year ends on the last Saturday in February. Fiscal 1997 ended February 28, 1998, fiscal 1996 ended February 22, 1997 and fiscal 1995 ended February 24, 1996. Fiscal 1997 was comprised of 53 weeks while fiscal 1996 and fiscal 1995 were each comprised of 52 weeks.

### *Common Stock*

The principal shareholder of the Company, Tengelmann Warenhandelsgesellschaft, owned 54.67% of the Company's common stock as of February 28, 1998.

### *Cash and Short-term Investments*

Short-term investments that are highly liquid with an original maturity of three months or less are included in cash and short-term investments and are deemed to be cash equivalents.

### *Inventories*

Store inventories are valued principally at the lower of cost or market with cost determined under the retail method. Warehouse and other inventories are valued primarily at the lower of cost or market with cost determined on a first-in, first-out basis. Inventories of certain acquired companies are valued using the last-in, first-out method, which was their practice prior to acquisition.

### *Advertising Costs*

Advertising costs are expensed as incurred. The Company recorded advertising expense of \$138 million for each of the three fiscal years in the period ended February 28, 1998.

### *Properties*

Depreciation and amortization are provided on the straight-line basis over the estimated useful lives of the assets. Buildings are depreciated based on lives varying from twenty to fifty years and equipment based on lives varying from three to ten years. Real property leased under capital leases is amortized over the lives of the respective leases or over their economic useful lives, whichever is less. During fiscal 1997 the Company disposed of certain assets which resulted in a pretax gain of approximately \$11 million.

### *Pre-opening Costs*

The costs of opening new stores are expensed in the year incurred.

### *Earnings Per Share*

In the fourth quarter of fiscal 1997, the Company adopted Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128"). SFAS 128 requires dual presentation of basic and diluted earnings per share ("EPS") on the face of the statements of consolidated operations and requires a reconciliation of the numerators and denominators of the basic and diluted EPS calculations. Basic EPS is computed by dividing net income by the weighted average shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if options to issue common stock were exercised and converted to common stock. Earnings per share for prior periods have been computed in accordance with SFAS 128.

The weighted average shares outstanding utilized in the basic earnings per share calculations were 38,249,832 for fiscal 1997, 38,221,329 for fiscal 1996 and 38,220,333 for fiscal 1995. The common stock equivalents that were added to the weighted average shares outstanding for purposes of diluted earnings per share were 19,926 for fiscal 1997, 66,260 for fiscal 1996 and 1,374 for fiscal 1995.

### *Excess of Cost over Net Assets Acquired*

The excess of cost over fair value of net assets acquired is amortized on a straight-line basis over forty years. The Company recorded amortization expense of \$1.5 million for each of the three fiscal years in the period ended February 28, 1998. The accumulated amortization relating to goodwill amounted to \$11.7 million and \$10.2 million at February 28, 1998 and February 22, 1997, respectively. At each balance sheet date, Management reassesses the appropriateness of the goodwill balance based on forecasts of cash flows from operating results on an undiscounted basis. If the results of such comparison indicate that an impairment may exist, the Company will recognize a charge to operations at that time based upon the difference between the present value of the expected cash flows from future operating results (utilizing a discount rate equal to the Company's average cost of funds at that time) and the balance sheet value. The recoverability of goodwill is at risk to the extent the Company is unable to achieve its forecast assumptions regarding cash flows from operating results. At February 28, 1998, the Company estimates that the cash flows projected to be generated by the respective businesses on an undiscounted basis should be sufficient to recover the existing goodwill balance over its remaining life.

### *Long-Lived Assets*

The Company adopted the provisions of Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS 121") during the fourth quarter of fiscal 1995. SFAS 121 establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related



to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of. The Company reviews the carrying values of its long-lived and identifiable intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable.

Such review is based upon groups of assets and the undiscounted estimated future cash flows from such assets to determine if the carrying value of such assets are recoverable from their respective cash flows. The adoption of SFAS No. 121 did not have an effect on the financial position or results of operations of the Company.

#### *Income Taxes*

The Company provides deferred income taxes on temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws.

#### *Current Liabilities*

Certain accounts payable checks issued but not presented to banks frequently result in negative book balances for accounting purposes. Such amounts are classified as "Book overdrafts" in the accompanying balance sheets.

The Company accrues for vested and non-vested vacation pay. Liabilities for compensated absences of \$79 million at both February 28, 1998 and February 22, 1997 are included in the balance sheet caption "Accrued salaries, wages and benefits."

#### *Stock-Based Compensation*

Effective February 25, 1996, the Company adopted Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123"). In conjunction with the adoption, the Company will continue to apply the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" with pro forma disclosure of net income and earnings per share as if the fair value based method prescribed by SFAS 123 had been applied.

#### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The accompanying balance sheets include liabilities with respect to self-insured workers' compensation and general liability claims. The Company determines the required liability of such claims based upon various assumptions which include, but are not limited to, the Company's historical loss experience, industry loss standards, projected loss development factors,

projected payroll, employee headcount and other internal data. It is reasonably possible that the final resolution of some of these claims may require significant expenditures by the Company in excess of its existing reserves, over an extended period of time and in a range of amounts that cannot be reasonably estimated.

#### *Reclassifications*

Certain reclassifications have been made to the prior years' financial statements in order to conform to the current year's presentation.

#### *New Accounting Pronouncements Not Yet Adopted*

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130 "Reporting Comprehensive Income" ("SFAS 130") and SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). SFAS 130 relates to the change in the equity of a business during a reporting period from transactions of the business. The Company currently intends to adopt this new accounting standard effective in the first quarter of fiscal 1998. The expected impact in the adoption of SFAS 130 is not readily determinable as the impact is predicated on the future changes in the Canadian exchange rate. SFAS 131 supersedes SFAS No. 14 "Financial Reporting for Segments of a Business Enterprise". SFAS 131 provides for the disclosure of financial information disaggregated by the way management organizes the segments of the enterprise for making operating decisions. The Company is currently assessing the extent of disclosures that will be required by SFAS 131 and will adopt this statement in fiscal 1998.

In February 1998, the FASB issued SFAS No. 132 "Employer's Disclosures about Pensions and Other Postretirement Benefits" ("SFAS 132"). SFAS 132 standardizes the disclosure requirements for pensions and other postretirement benefits. It does not address the accounting for such benefits. SFAS 132 is effective for fiscal years beginning after December 31, 1997 and requires restatement of disclosures for all prior periods presented. The Company will adopt SFAS 132 in fiscal 1998 and believes it will impact the financial statements to the extent that it is necessary to provide additional disclosure about the Company's pensions and other postretirement benefits.

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#### INVENTORY

Approximately 27% of the Company's inventories are valued using the last-in, first-out ("LIFO") method at both February 28, 1998 and February 22, 1997. Such inventories would have been \$14 million and \$15 million higher at February 28, 1998 and February 22, 1997, respectively, if the retail and first-in,



first-out methods were used. The Company recorded LIFO charges of approximately \$1 million and \$2 million during fiscal years 1996 and 1995, respectively. During fiscal year 1997, the Company recorded a LIFO credit of \$0.4 million. Liquidation of LIFO layers in the periods reported did not have a significant effect on the results of operations.

### FOOD BASICS FRANCHISE BUSINESS

The Company serviced 52 Food Basics franchised stores as of February 28, 1998 and 49 stores as of February 22, 1997. These franchised stores are required to purchase inventory exclusively from the Company which acts as a wholesaler to the franchisees. During fiscal 1997 and 1996, the Company had wholesale sales to these franchised stores of \$340 million and \$205 million, respectively. A majority of the Food Basics franchised stores were converted from Company operated supermarkets. The Company subleases the stores and leases the equipment in the stores to the franchisees. The Company also provides merchandising, advertising, accounting and other consultative services to the franchisees for which it receives a nominal fee which mainly represents the reimbursements of costs incurred to provide such services (see "Lease Obligations" footnote).

Included in other assets are Food Basics franchised business receivables, net of allowance for doubtful accounts, amounting to \$37.6 million as of February 28, 1998 and \$40.2 million as of February 22, 1997. The inventory notes are collateralized by the inventory in the stores, while the equipment lease receivables are collateralized by the equipment in the stores. The current portion of the inventory and equipment leases of approximately \$1.9 million as of February 28, 1998 and \$2.4 million as of February 22, 1997 are included in accounts receivable. The repayment of the inventory notes and equipment leases are dependent on positive operating results of the stores. To the extent that the franchisees incur operating losses, the Company establishes an allowance for doubtful accounts. The Company continually assesses the sufficiency of the allowance on a store by store basis based upon the operating losses incurred and the related collateral underlying the amounts due from the franchisees. In the event of default by a franchisee, the Company reserves the option to reacquire the inventory and equipment at the store and operate the franchise as a corporate owned store.

Included below are the amounts due to the Company for the next five years and thereafter from the franchised stores for equipment leases and inventory notes.

<i>(Dollars in thousands)</i>	
1998	\$ 5,379
1999	6,595
2000	6,595
2001	6,595
2002	6,595
2003 and thereafter	20,694
	52,453
Less interest portion	12,897
Due from Food Basics franchise business	\$ 39,556

For the fiscal years ended February 28, 1998 and February 22, 1997 approximately \$2 million and \$34 million, respectively, of the franchise business notes relate to equipment leases which were non-cash transactions and accordingly, have been excluded from the consolidated statements of cash flows.

### INDEBTEDNESS

Debt consists of:

<i>(Dollars in thousands)</i>	February 28, 1998	February 22, 1997
7.75% Notes, due April 15, 2007	\$ 300,000	\$ —
9 1/8% Notes, due January 15, 1998	—	200,000
7.70% Senior Notes, due January 15, 2004	200,000	200,000
7.78% Notes, due November 1, 2000	75,000	75,000
Mortgages and Other Notes, due 1998 through 2014 (average interest rates at year end of 6.70% and 9.35%, respectively)	11,972	38,878
U.S. Bank Borrowings at 5.86% and 5.76%, respectively	127,500	147,000
Canadian Commercial Paper at 3.44%	—	2,192
Canadian Bank Borrowings at 3.65%	—	56,956
Less unamortized discount on 7.75% and 9 1/8% Notes	(2,356)	(127)
	712,116	719,899
Less current portion	(16,824)	(18,290)
Long-term debt	\$ 695,292	\$ 701,609

On June 10, 1997, the Company executed an unsecured five year \$465 million U.S. credit agreement and a five year C\$50 million Canadian credit agreement (the "1997 Credit Agreement") with a syndicate of banks, enabling it to borrow funds on a revolving basis sufficient to refinance short-term borrowings. This 1997 Credit Agreement replaced a previous five year \$400 million U.S. revolving credit agreement and a C\$100 million revolving credit agreement dated December 12, 1995. The 1997 Credit Agreement resulted in the Company obtaining a lower cost of borrowing, reduced facility fees, and extended the maturity to June 2002. The Company pays a facility fee ranging from 3/16% to 1/2% per annum on the total commitment of the U.S. and Canadian revolving credit facilities. Borrowings under the U.S. revolving credit agreement were \$90 million and \$95 million at February 28, 1998 and February 22, 1997, respectively. The Canadian subsidiary had no outstanding borrowings at February 28, 1998 and \$59 million at February 22, 1997. As of February 28, 1998, the Company had available \$375 million under its U.S. credit agreement and C\$50 million (U.S. \$35 million at February 28, 1998) under the Canadian credit agreement. As of February 22, 1997, the Company had available \$305 million under its U.S. credit agreement and C\$19 million (U.S. \$14 million at February 22, 1997) under the Canadian credit agreement. In addition, the U.S. has uncommitted lines of credit with various banks amounting to \$149 million and \$145 million as of February 28, 1998 and February 22, 1997, respectively.



Borrowings under these uncommitted lines of credit amounted to \$38 million and \$52 million as of February 28, 1998 and February 22, 1997, respectively.

As of February 28, 1998, the Company had outstanding a total of \$575 million of unsecured, non-callable public debt securities in the form of \$75 million 7.78% Notes due November 1, 2000, \$200 million 7.70% Notes due January 15, 2004 and \$300 million 7.75% Notes due April 15, 2007. As of February 28, 1998, the Company had \$410 million available under the 1997 Credit Agreement and \$111 million in uncommitted lines of credit.

On April 15, 1997, the Company issued \$300 million 7.75% 10 year Notes due April 15, 2007. The Company used the net proceeds to reduce bank borrowings under the U.S. and Canadian revolving credit facilities, prepay other indebtedness and for general corporate purposes. The Company borrowed funds available under the U.S. credit facility to repay at maturity indebtedness owing in respect of the Company's 9 1/8% Notes due January 15, 1998.

On October 17, 1995, the Company's Canadian subsidiary, The Great Atlantic & Pacific Company of Canada, Ltd. ("A&P Canada"), issued U.S. \$75 million of unsecured, non-callable 7.78% Notes due November 1, 2000 guaranteed by the Company. The net proceeds from the issuance of these Notes were used to repay indebtedness under the Canadian subsidiary's revolving credit facility. In conjunction with the issuance of the U.S. \$75 million Notes, A&P Canada entered into a five year cross-currency swap agreement expiring November 1, 2000. The cross-currency swap was executed for protection against the effect of a decrease in Canadian exchange rates on both the semi-annual interest payments and the final principal payment due to the Company's U.S. bondholders. The cross-currency swap enables the Company to pay in Canadian dollars a fixed rate of interest of 9.23% on a notional amount of C\$100 million for the \$75 million 7.78% Notes denominated in U.S. dollars. The cost of the cross-currency swap of 1.45% is charged to interest expense. The Company records an asset or liability to the extent that an eventual transaction gain or loss is expected to be recorded upon the settlement of the notional amount of the underlying debt. Accordingly, the Company has recorded in other assets the receivable due from the counterparty amounting to approximately \$4.5 million and \$1.4 million as of February 28, 1998 and February 22, 1997, respectively. The fair value of the cross-currency swap was favorable to the Company by \$1 million as of February 28, 1998 and unfavorable to the Company by \$5.4 million as of February 22, 1997. The Company is exposed to credit losses in the event of nonperformance by the counterparty to its currency swap. However, the Company anticipates that the counterparty will be able to fully satisfy its obligations under the contracts.

On April 15, 1997, A&P Canada entered into an interest rate swap agreement with a notional amount of C\$100 million where the Company receives a fixed rate of interest and pays a variable rate of interest. The fair value of the interest rate swap was favorable to the Company by \$1.4 million as of February 28, 1998.

The Company's loan agreements and certain of its notes contain various financial covenants which require, among other things, minimum net worth and maximum levels of indebtedness and lease commitments. The Company was in compliance with all such financial covenants as of February 28, 1998 and believes that it will continue to be in compliance.

The net book value of real estate pledged as collateral for all mortgage loans amounted to approximately \$14 million and \$48 million as of February 28, 1998 and February 22, 1997, respectively.

In the second quarter of fiscal 1997, the Company recorded an extraordinary charge of \$0.5 million, net of a tax benefit of \$0.4 million relating to the early extinguishment of debt which amounted to \$.01 per share - basic and diluted. The Company retired at a premium approximately \$20 million in mortgages with a weighted average interest rate of 9.4%.

The U.S. bank borrowings of \$118 million as of February 28, 1998 are classified as non-current as the Company has the ability and intent to refinance these borrowings on a long-term basis.

Maturities for the next five fiscal years and thereafter are: 1998-\$17 million; 1999-\$14 million; 2000-\$106 million; 2001-\$40 million; 2002-\$37 million; 2003 and thereafter - \$498 million. Interest payments on indebtedness were approximately \$58 million for fiscal 1997, \$49 million for fiscal 1996 and \$54 million for fiscal 1995.

## FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Company's financial instruments are as follows:

<i>(Dollars in thousands)</i>	February 28, 1998		February 22, 1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Liabilities:				
7.75% Notes, due April 15, 2007	\$297,644	\$299,531	\$ —	\$ —
9 1/8% Notes, due January 15, 1998	\$ —	\$ —	\$199,873	\$204,296
7.70% Senior Notes, due January 15, 2004	\$200,000	\$205,376	\$200,000	\$203,390
7.78% Notes, due November 1, 2000	\$ 75,000	\$ 75,832	\$ 75,000	\$ 76,912
Total Indebtedness	\$ 712,116	\$720,211	\$719,899	\$729,624

Fair value for the public debt securities is based on quoted market prices. With respect to all other indebtedness, Management has evaluated such debt instruments and has determined, based on interest rates and terms, that the fair value of such indebtedness approximates carrying value at February 28, 1998 and February 22, 1997. As of February 28, 1998 and February 22, 1997, the carrying



*Notes to Consolidated Financial Statements, Continued*

values of cash and short-term investments, accounts receivable and accounts payable approximated fair values due to the short-term maturities of these instruments.

On April 15, 1997, the Company's Canadian subsidiary entered into an interest rate swap agreement with a notional amount of C\$100 million where the Company receives a fixed rate of interest and pays a variable rate of interest.

At February 28, 1998 and February 22, 1997, the estimated fair values of the cross-currency swap and interest rate swap agreements were as follows:

(Dollars in thousands)	February 28, 1998		February 22, 1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cross-currency swap	\$ 4,504	\$ 1,077	\$ 1,432	\$(5,387)
Interest rate swap	—	1,350	—	—
Total cross-currency/ interest rate swap	\$ 4,504	\$ 2,427	\$ 1,432	\$(5,387)

The fair values were determined by the counterparty which is a widely recognized investment banker.

As of the end of fiscal 1997, the Company holds equity securities of both common and cumulative preferred stock in Isosceles PLC which were written-off in their entirety during fiscal 1992. There are no quoted market prices for these securities and it is not practicable, considering the materiality of these securities to the Company, to obtain an estimate of their fair value. The Company believes that the fair value for these securities is zero based upon Isosceles' current and prior years' results.

## LEASE OBLIGATIONS

The Company operates primarily in leased facilities. Lease terms generally range up to twenty-five years for store leases and thirty years for other leased facilities, with options to renew for additional periods. The majority of the leases contain escalation clauses relating to real estate tax increases and certain store leases provide for increases in rentals when sales exceed specified levels. In addition, the Company also leases some store equipment and trucks.

The consolidated balance sheets include the following:

(Dollars in thousands)	February 28, 1998	February 22, 1997
Real property leased under capital leases	\$213,076	\$223,507
Accumulated amortization	(123,018)	(120,033)
	\$ 90,058	\$103,474

The Company did not enter into any new capital leases during fiscal 1997 and 1995. During fiscal 1996, the Company entered into new capital leases totaling \$22 million. These capital lease amounts are non-cash transactions and, accordingly, have been excluded from the consolidated statement of cash flows. Interest paid as part of capital lease obligations was approximately \$16, \$17 and \$18 million in fiscal 1997, 1996 and 1995, respectively.

Rent expense for operating leases consists of:

(Dollars in thousands)	Fiscal 1997	Fiscal 1996	Fiscal 1995
Minimum rentals	\$181,061	\$162,752	\$154,439
Contingent rentals	5,109	5,383	5,890
	\$186,170	\$168,135	\$160,329

Future minimum annual lease payments for capital leases and noncancelable operating leases in effect at February 28, 1998 are shown in the table below. All amounts are exclusive of lease obligations and sublease rentals applicable to facilities for which reserves have previously been established. In addition, the Company subleases 52 stores to the Food Basics franchise business. Included in the operating lease table below are the rental payments made by the Company offset by the rental income received from the Food Basics franchised stores.

(Dollars in thousands)	Capital Leases Real Property	Operating Leases
Fiscal		
1998	\$ 27,146	\$ 192,841
1999	25,355	185,661
2000	24,271	178,189
2001	23,135	169,274
2002	21,113	156,747
2003 and thereafter	127,328	1,406,972
	248,348	\$2,289,684
Less executory costs	(1,818)	
Net minimum rentals	246,530	
Less interest portion	(113,257)	
Present value of net minimum rentals	\$ 133,273	

## INCOME TAXES

The components of income before income taxes and extraordinary item are as follows:

(Dollars in thousands)	Fiscal 1997	Fiscal 1996	Fiscal 1995
United States	\$45,644	\$ 68,478	\$ 73,364
Canadian	37,256	32,113	7,728
Total	\$82,900	\$100,591	\$81,092

The provision for income taxes before extraordinary item consists of the following:

(Dollars in thousands)	Fiscal 1997	Fiscal 1996	Fiscal 1995
Current:			
Federal	\$ 4,171	\$ 24,228	\$ 15,129
Canadian	700	700	(5,622)
State and local	3,018	3,698	4,865
	7,889	28,626	14,372
Deferred:			
Federal	11,076	(926)	9,387
Canadian	16,624	14,329	3,448
State and local	349	(141)	109
Canadian valuation allowance	(16,624)	(14,329)	(3,448)
	11,425	(1,067)	9,496
	\$19,314	\$27,559	\$23,868

The deferred income tax provision (benefit) results primarily from the annual change in temporary differences between amounts of



assets and liabilities for financial reporting purposes and such amounts as measured by tax laws, Canadian net operating tax loss carryforwards and the Canadian valuation allowance.

During fiscal 1994, Management assessed the likelihood of realizing the Canadian net deferred income tax assets and, based on all available evidence, concluded that it was not likely that such assets would be realized. Accordingly, the Company recorded a valuation allowance of \$119.6 million against Canadian deferred tax assets. These deferred tax assets resulted from tax loss carryforwards and deductible temporary differences arising from the Canadian write-off of goodwill and long-lived assets during fiscal 1994.

During fiscal 1997, since the Canadian operations generated pretax earnings, the Company reversed approximately \$17 million of the valuation allowance, which was an increase of \$3 million from the fiscal 1996 reversal of \$14 million. Although Canada generated pretax earnings in fiscal 1997 of \$37 million and \$32 million in fiscal 1996, the Company was unable to conclude that the Canadian deferred tax assets were more likely than not to be realized. This conclusion was based in part on Management's assessment of the competitive Canadian marketplace and the level of the Canadian earnings. Accordingly, at February 28, 1998 the Company is continuing to fully reserve its Canadian net deferred tax asset. The valuation allowance will be adjusted when and if, in the opinion of Management, significant positive evidence exists which indicates that it is more likely than not that the Company will be able to realize the Canadian net deferred tax asset. The positive evidence that Management believes is necessary in order to reverse some or all of the Canadian deferred tax asset valuation allowance is a trend in earnings to a level which would allow Management to conclude that it is more likely than not that a portion or all of the deferred tax assets would be realized. The Canadian pretax income for financial statement purposes is higher than the taxable income for tax purposes due to certain differences between the financial statement and income tax treatment of certain items. This is of further significance since the largest portion of the Canadian deferred tax asset relates to net operating loss carryforwards which are to expire between fiscal 1999 and fiscal 2002.

During fiscal 1994, the Company made an election to permanently reinvest prior years' earnings of the Canadian subsidiary. Accordingly, the Company does not provide for taxes associated with Canada's undistributed earnings.

The Company's Canadian net operating tax loss carryforwards of approximately \$135 million will expire between February 2000 and February 2003.

A reconciliation of income taxes at the 35% federal statutory income tax rate for fiscal 1997, 1996 and 1995 to income taxes as reported is as follows:

<i>(Dollars in thousands)</i>	Fiscal 1997	Fiscal 1996	Fiscal 1995
Income taxes computed at federal statutory income tax rate	\$ 29,015	\$35,207	\$ 28,382
State and local income taxes, net of federal tax benefit	2,188	2,312	3,233
Tax rate differential relating to Canadian operations	4,155	3,789	(4,879)
Canadian valuation allowance	(16,624)	(14,329)	(3,448)
Goodwill	580	580	580
Income taxes, as reported	\$ 19,314	\$27,559	\$ 23,868

The fiscal 1995 tax rate differential relating to Canadian operations in the above table includes a \$6.5 million benefit related to a refund of previously paid Canadian taxes.

Income tax payments, net of refunds, for fiscal 1996 and 1995 were approximately \$13 and \$19 million, respectively. For fiscal 1997 the Company had net income tax refunds of \$1 million.

The components of net deferred tax assets (liabilities) are as follows:

<i>(Dollars in thousands)</i>	February 28, 1998	February 22, 1997
Current assets:		
Insurance reserves	\$ 22,420	\$ 24,186
Other reserves	5,031	6,552
Accrued postretirement and postemployment benefits	3,038	3,038
Lease obligations	1,619	1,817
Pension obligations	3,827	2,390
Miscellaneous	2,870	3,013
	38,805	40,996
Current liabilities:		
Inventories	(14,819)	(14,819)
Health and welfare	(9,960)	(9,534)
Miscellaneous	(7,083)	(5,997)
	(31,862)	(30,350)
Valuation allowance	(3,005)	(3,337)
Deferred income taxes included in prepaid expenses and other assets	\$ 3,938	\$ 7,309
Non-current assets:		
Isosceles investment	\$ 42,617	\$ 42,617
Fixed assets	4,077	4,061
Other reserves	6,177	5,420
Lease obligations	17,354	19,166
Canadian loss carryforwards	60,270	80,494
Insurance reserves	4,200	6,720
Accrued postretirement and postemployment benefits	29,808	28,110
Pension obligations	6,800	6,300
Step rents	11,352	9,625
Miscellaneous	7,759	8,677
	190,414	211,190
Non-current liabilities:		
Fixed assets	(212,044)	(205,153)
Pension obligations	(22,981)	(21,050)
Miscellaneous	(2,404)	(1,936)
	(237,429)	(228,139)
Valuation allowance	(73,603)	(96,239)
Deferred income taxes	\$ (120,618)	\$ (113,188)



## RETIREMENT PLANS AND BENEFITS

*Defined Benefit Plans*

The Company provides retirement benefits to certain non-union and some union employees under various defined benefit plans. The Company's defined benefit pension plans are non-contributory and benefits under these plans are generally determined based upon years of service and, for salaried employees, compensation. The Company funds these plans in amounts consistent with the statutory funding requirements.

The components of net pension cost are as follows:

<i>(Dollars in thousands)</i>	Fiscal 1997	Fiscal 1996	Fiscal 1995
Service cost	\$ 11,942	\$ 10,826	\$ 9,340
Interest cost	26,192	24,798	23,976
Actual return on plan assets	(45,893)	(34,921)	(42,724)
Net amortization and deferral	14,908	5,254	16,362
Net pension cost	\$ 7,149	\$ 5,957	\$ 6,954

The Company's defined benefit pension plans are accounted for on a calendar year basis. The majority of plan assets is invested in listed stocks and bonds. The funded status of the plans is as follows:

<i>(Dollars in thousands)</i>	1997		1996	
	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets
Accumulated benefit obligation:				
Vested	\$286,909	\$100,618	\$300,111	\$38,726
Nonvested	3,568	2,001	3,766	1,907
	\$290,477	\$102,619	\$303,877	\$40,633
Projected benefit obligation	\$296,333	\$107,637	\$312,762	\$42,969
Plan assets at fair value	362,538	81,870	378,903	22,600
Excess (deficiency) of assets over projected benefit obligation	66,205	(25,767)	66,141	(20,369)
Unrecognized net transition (asset) obligation	(5,880)	398	(7,446)	483
Unrecognized net (gain) loss from experience differences	(17,809)	7,119	(15,059)	(1,109)
Unrecognized prior service cost	2,311	4,130	3,082	3,964
Additional minimum liability	—	(8,985)	—	(2,824)
Prepaid pension asset (pension liability)	\$ 44,827	\$ (23,105)	\$ 46,718	\$ (19,855)

The prepaid pension asset is included in other assets while the pension liability is included in accrued salaries, wages and benefits and other non-current liabilities.

At February 28, 1998, the Company's additional minimum pension liability for its defined benefit plans was in excess of the unrecognized prior service costs and net transition obligation and accordingly, \$6.2 million was reflected as a reduction to shareholders' equity. The amount was not tax effected as it related to the Canadian subsidiary which has its deferred tax assets fully reserved by a valuation allowance.

During the year ended February 25, 1995, the Company's Canadian subsidiary and the United Food & Commercial Workers International Union, Locals 175 and 633, entered into an agreement which will result in the amalgamation of three of the Company's Canadian defined benefit pension plans with the Canadian Commercial Workers Industry Pension Plan ("CCWIPP"), retroactive to July 1, 1994, subject to the approval of the CCWIPP trustees and the appropriate regulatory bodies. Under the terms of this agreement, CCWIPP will assume the assets and defined benefit liabilities of the three pension plans and the Company will be required to make defined contributions to CCWIPP based upon hours worked by employees who are members of CCWIPP. The Company expects that the necessary approvals will be received by January 1999. The transfer to CCWIPP has been delayed for the past three years as the regulatory bodies have taken longer to review the transfer than originally anticipated. The Company will not change the reporting for these three plans until such approval is received. Accordingly, at February 28, 1998 and February 22, 1997, prepaid pension assets of approximately \$11 million and \$15 million, respectively, related to the aforementioned plans are included in the above table.

Actuarial assumptions used to determine year-end plan status are as follows:

	1997		1996	
	U.S.	Canada	U.S.	Canada
Discount rate	7.00%	6.75%	7.50%	7.75%
Weighted average rate of compensation increase	4.00%	4.00%	4.50%	4.00%
Expected long-term rate of return on plan assets	8.00%	8.40%	8.50%	8.80%

The impact of the changes in the actuarial assumptions has been reflected in the funded status of the pension plans and the Company believes that such changes will not have a material effect on net pension cost for fiscal 1998.

*Defined Contribution Plans*

The Company maintains a defined contribution retirement plan to which the Company contributes an amount equal to 4% of eligible participants' salaries and a savings plan to which eligible participants may contribute a percentage of eligible salary. The Company contributes to the savings plan based on specified percentages of the participants' eligible contributions. Participants become fully vested in the Company's contributions after 5 years of service. The Company's contributions charged to operations for both plans were approximately \$11 million in each of the three fiscal years in the period ended February 28, 1998.

The Company participates in various multi-employer union pension plans which are administered jointly by management and union representatives and which sponsor most full-time and certain part-time union employees who are not covered by the Company's other pension plans. The pension expense for these plans approximated \$38 million in each of the three fiscal years in the period ended February 28, 1998. The Company could, under certain



circumstances, be liable for unfunded vested benefits or other expenses of jointly administered union/management plans. At this time, the Company has not established any liabilities because such withdrawal from these plans is not probable.

### Postretirement Benefits

The Company provides postretirement health care and life benefits to certain union and non-union employees. The Company recognizes the cost of providing postretirement benefits during employees' active service period.

The components of net postretirement benefits cost are as follows:

(Dollars in thousands)	Fiscal 1997	Fiscal 1996	Fiscal 1995
Service cost	\$ 788	\$ 794	\$ 600
Interest cost	2,518	2,394	2,900
Net amortization and deferral	(1,056)	(1,100)	(800)
Net postretirement benefits cost	\$2,250	\$2,088	\$2,700

The unfunded status of the plans is as follows:

(Dollars in thousands)	Fiscal 1997	Fiscal 1996
Unfunded accumulated benefit obligation:		
Retirees	\$19,102	\$17,680
Fully eligible active plan participants	10,760	4,026
Other active plan participants	19,118	13,225
	48,980	34,931
Unrecognized net gain from experience differences	1,976	16,407
Accrued postretirement costs	\$50,956	\$51,338
Assumed discount rate	7.0%	7.5%

The assumed rate of future increase in health care benefit cost was 9.50% in fiscal 1997 and is expected to decline to 5.0% by the year 2020 and remain at that level thereafter. The effect of a one-percentage-point increase in the assumed health care cost trend rate for each future year on the net postretirement health care cost and the accumulated postretirement benefit obligation would be approximately \$0.6 million and \$5.0 million, respectively.

### Postemployment Benefits

The Company accrues costs for preretirement postemployment benefits provided to former or inactive employees and recognizes an obligation for these benefits. The costs of these benefits have been included in operations for each of the three fiscal years in the period ended February 28, 1998. As of February 28, 1998 and February 22, 1997, the Company has a liability reflected in the balance sheet of \$25 million with respect to such benefits.

## STOCK OPTIONS

Effective February 25, 1996, the Company adopted SFAS 123 which establishes financial accounting and reporting standards for stock-based employee compensation plans. SFAS 123 encourages all entities to adopt a fair value based method of accounting for stock-based compensation plans in which compensation cost is measured at the date the award is granted based on the fair value of the award and is recognized over the employees' service period. However, SFAS 123 allows an entity to continue to use the intrinsic value-based method

prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), with pro forma disclosures of net income and earnings per share as if the fair value based method had been applied. APB 25 requires compensation expense to be recognized over the employees' service period based on the excess, if any, of the quoted market price of the stock at the date the award is granted or other measurement date, as applicable, over an amount an employee must pay to acquire the stock.

At February 28, 1998, the Company has three fixed stock-based compensation plans. The Company applies the principles of APB 25 for stock options and FASB Interpretation No. 28 for stock appreciation rights ("SAR's"). Most of the options vest over a four year period on the anniversary date of issuance, while some options vest immediately.

The 1994 Stock Option Plan for officers and key employees provides for the granting of 1,500,000 shares as either options or SAR's. Options and SAR's issued under this plan are granted at the fair market value of the Company's common stock at the date of grant. The 1984 Stock Option Plan for officers and key employees, which expired on February 1, 1994, provided for the granting of 1,500,000 shares and was amended as of July 10, 1990 to increase by 1,500,000 the number of options available for grant as either options or SAR's. Each option was available for grant at the fair market value of the Company's common stock on the date the option was granted. SAR's allow the holder, in lieu of purchasing stock, to receive cash in an amount equal to the excess of the fair market value of common stock on the date of exercise over the option price. A total of 327,500 options and 10,000 SAR's was granted in fiscal 1997 under the 1994 plan.

The 1994 Stock Option Plan for Board of Directors provides for the granting of 100,000 stock options at the fair market value of the Company's common stock at the date of grant. Options granted under this plan in fiscal 1997, 1996 and 1995 totaled 1,600, 5,200 and 1,800, respectively.

The fair value of the fiscal 1997, 1996 and 1995 option grants was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: fiscal 1997, 1996 and 1995; expected volatility of 30% and expected life of 7 years for all three years and dividend yield between 1.26% and 1.63% in fiscal 1997 and 0.72% and 0.91% in both fiscal 1996 and 1995. The risk-free interest rates used for the grants are between 6.11% and 6.84% in fiscal 1997 and 5.57% and 6.94% in both fiscal 1996 and 1995.

The Company recognized compensation expense of \$1.4 million in fiscal 1997, \$5.8 million in fiscal 1996 and \$0.3 million in fiscal 1995 with respect to SAR's. There was no compensation expense recognized for the other fixed plans since the exercise price of the stock options equaled the fair market value the Company's common stock on the date of grant. Had compensation cost for the Company's stock options been determined based on the fair value at the grant dates for awards under those plans consistent with the fair value methods prescribed by SFAS 123, the Company's net income and



earnings per share would have been reduced to the pro forma amounts indicated below:

<i>(Dollars in thousands, except per share amounts)</i>			
	Fiscal 1997	Fiscal 1996	Fiscal 1995
Net Income:			
As reported	\$63,042	\$73,032	\$57,224
Pro forma	\$61,584	\$71,920	\$56,624
Earnings Per Share - basic and diluted:			
As reported	\$ 1.65	\$ 1.91	\$ 1.50
Pro forma	\$ 1.61	\$ 1.88	\$ 1.48

The pro forma effect on net income and earnings per share may not be representative of the pro forma effect in future years because it includes compensation cost on a straight-line basis over the vesting periods of the grants and does not take into consideration the pro forma compensation costs for grants made prior to fiscal 1995.

A summary of option transactions is as follows:

<i>Officers, Key Employees and Directors</i>		Weighted Average Exercise Price
	Shares	
Outstanding February 25, 1995	84,800	\$24.82
Granted	670,800	27.71
Cancelled or expired	(10,000)	27.88
Outstanding February 24, 1996	745,600	\$27.38
Granted	70,200	27.72
Cancelled or expired	(63,350)	26.13
Exercised	(27,383)	23.85
Outstanding February 22, 1997	725,067	\$27.66
Granted	329,100	28.06
Cancelled or expired	(98,967)	27.76
Exercised	(5,250)	27.88
Outstanding February 28, 1998	949,950	\$27.78
Exercisable at:		
February 22, 1997	182,400	\$27.58
February 28, 1998	312,367	\$27.60
Weighted average fair value of options granted during the year ended:		
February 24, 1996		\$11.45
February 22, 1997		\$11.94
February 28, 1998		\$10.96

A summary of stock options outstanding and exercisable at February 28, 1998 is as follows:

Options Outstanding			Options Exercisable		
Range Of Exercise Prices	Number Outstanding at Feb. 28, 1998	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at Feb. 28, 1998	Weighted Average Exercise Price
\$21.500-\$26.125	101,200	8.7 years	\$24.61	13,700	\$23.30
\$26.500-\$27.500	128,600	8.5 years	\$27.28	28,250	\$27.08
\$27.625-\$27.750	121,200	8.4 years	\$27.73	15,934	\$27.63
\$27.875	508,750	7.3 years	\$27.88	252,750	\$27.88
\$30.375-\$31.688	90,200	9.5 years	\$31.62	1,733	\$30.46
	<u>949,950</u>			<u>312,367</u>	

A summary of SAR transactions is as follows:

<i>Officers and Key Employees</i>	Shares	Price Range Per Share
Outstanding February 25, 1995	2,385,125	\$21.50 - \$65.13
Granted	10,000	21.88
Cancelled or expired	(166,750)	23.38 - 46.38
Exercised	(75,625)	21.50 - 24.75
Outstanding February 24, 1996	2,152,750	\$21.50 - \$65.13
Granted	86,500	27.25 - 31.63
Cancelled or expired	(20,000)	27.38 - 56.13
Exercised	(247,237)	21.50 - 34.75
Outstanding February 22, 1997	1,972,013	\$21.88 - \$65.13
Granted	10,000	26.63
Cancelled or expired	(136,750)	23.38 - 52.38
Exercised	(187,275)	23.00 - 27.25
Outstanding February 28, 1998	1,657,988	\$21.88 - \$65.13
Exercisable at:		
February 22, 1997	1,647,388	\$23.00 - \$65.13
February 28, 1998	1,596,863	\$21.88 - \$65.13

## LITIGATION

The Company is involved in various claims, administrative agency proceedings and lawsuits arising out of the normal conduct of its business. Although the ultimate outcome of these legal proceedings cannot be predicted with certainty, the management of the Company believes that the resulting liability, if any, will not have a material effect upon the Company's consolidated financial statements or liquidity.

## OPERATIONS IN GEOGRAPHIC AREAS

The Company has been engaged in the retail food business since 1859 and currently does business principally under the names A&P, Waldbaum's, Food Emporium, Super Fresh, Farmer Jack, Kohl's, Sav-A-Center, Dominion, and Food Basics. Sales in the table below reflect sales to unaffiliated customers in the United States and Canada as well as wholesale sales to franchised stores.

<i>(Dollars in thousands)</i>	Fiscal 1997	Fiscal 1996	Fiscal 1995
Sales:			
United States	\$ 8,344,253	\$ 8,281,925	\$ 8,365,327
Foreign	1,917,990	1,807,089	1,736,029
Total	\$ 10,262,243	\$ 10,089,014	\$ 10,101,356

### Income From Operations:

United States	\$ 109,501	\$ 122,159	\$ 125,118
Foreign	45,758	47,144	26,616
Total	\$ 155,259	\$ 169,303	\$ 151,734

### Assets:

United States	\$ 2,521,008	\$ 2,549,500	\$ 2,438,353
Foreign	474,245	453,172	422,494
Total	\$ 2,995,253	\$ 3,002,672	\$ 2,860,847



## SUMMARY OF QUARTERLY RESULTS *(unaudited)*

The table below summarizes the Company's results of operations by quarter for fiscal 1997 and 1996. The first quarter of each fiscal year contains sixteen weeks while the other quarters each contain twelve weeks, except the fourth quarter of fiscal 1997 which contains thirteen weeks resulting from a 53 week year.

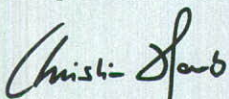
<i>(Dollars in thousands, except per share data)</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
1997					
Sales	\$ 3,104,591	\$2,335,695	\$2,318,821	\$2,503,136	\$10,262,243
Gross margin	884,216	673,467	663,727	713,468	2,934,878
Depreciation and amortization	71,439	53,963	53,763	55,071	234,236
Income from operations	53,006	38,640	30,753	32,860	155,259
Interest expense	24,418	18,928	18,670	18,136	80,152
Income before extraordinary item	22,787	16,207	11,234	13,358	63,586
Extraordinary loss on early extinguishment of debt	—	(544)	—	—	(544)
Net income	22,787	15,663	11,234	13,358	63,042
Per share data:					
Income (loss) per share before extraordinary item - basic and diluted	.60	.42	.29	.35	1.66
Extraordinary loss on early extinguishment of debt - basic and diluted	—	(.01)	—	—	(.01)
Net income - basic and diluted	.60	.41	.29	.35	1.65
Cash dividends	.10	.10	.10	.10	.40
Market price:					
High	31.375	27.875	36.000	32.750	
Low	23.125	24.125	25.313	26.750	
Number of stores at end of period	964	943	941	936	
Number of franchised stores served at end of period	48	48	52	52	
1996					
Sales	\$3,092,554	\$2,329,987	\$2,318,762	\$2,347,711	\$10,089,014
Gross margin	896,780	662,355	668,664	693,900	2,921,699
Depreciation and amortization	69,558	53,240	53,939	54,011	230,748
Income from operations	52,743	34,553	34,398	47,609	169,303
Interest expense	21,550	16,387	17,028	18,243	73,208
Net income	21,879	13,994	14,091	23,068	73,032
Per share data:					
Net income - basic and diluted	.57	.37	.37	.60	1.91
Cash dividends	.05	.05	.05	.05	.20
Market price:					
High	36.750	34.625	34.000	34.375	
Low	22.125	25.875	25.125	29.875	
Number of stores at end of period	993	977	974	973	
Number of franchised stores served at end of period	24	36	47	49	



## *Management's Report on Financial Statements*

The management of The Great Atlantic & Pacific Tea Company, Inc. has prepared the consolidated financial statements and related financial data contained in this Annual Report. The financial statements were prepared in accordance with generally accepted accounting principles appropriate to our business and, by necessity and circumstance, include some amounts which were determined using management's best judgments and estimates with appropriate consideration to materiality. Management is responsible for the integrity and objectivity of the financial statements and other financial data included in this report. To meet this responsibility, management maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that accounting records are reliable. Management supports a program of internal audits and internal accounting control reviews to provide reasonable assurance that the system is operating effectively.

The Board of Directors pursues its responsibility for reported financial information through its Audit Review Committee. The Audit Review Committee meets periodically and, when appropriate, separately with management, internal auditors and the independent auditors, Deloitte & Touche LLP, to review each of their respective activities.



Christian W.E. Haub  
President and  
Chief Executive Officer



Fred Corrado  
Vice Chairman of the Board  
and Chief Financial Officer

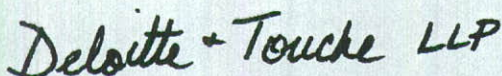
## *Independent Auditors' Report*

*To the Shareholders and Board of Directors of The Great Atlantic & Pacific Tea Company, Inc.:*

We have audited the accompanying consolidated balance sheets of The Great Atlantic & Pacific Tea Company, Inc. and its subsidiary companies as of February 28, 1998 and February 22, 1997 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three fiscal years in the period ended February 28, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of The Great Atlantic & Pacific Tea Company, Inc. and its subsidiary companies at February 28, 1998 and February 22, 1997 and the results of their operations and their cash flows for each of the three fiscal years in the period ended February 28, 1998 in conformity with generally accepted accounting principles.



Parsippany, New Jersey  
April 30, 1998



# Five-Year Summary of Selected Financial Data

The Great Atlantic & Pacific Tea Company, Inc.

	Fiscal 1997 (53 weeks)	Fiscal 1996 (52 weeks)	Fiscal 1995 (52 weeks)	Fiscal 1994 (52 weeks)	Fiscal 1993 (52 weeks)
<i>(Dollars in thousands, except per share data)</i>					
<b>Operating Results</b>					
Sales	\$10,262,243	\$10,089,014	\$10,101,356	\$10,331,950	\$10,384,077
Income (loss) from operations	155,259	169,303	151,734	(57,530)	68,280
Depreciation and amortization	234,236	230,748	225,449	235,444	235,910
Interest expense	80,152	73,208	73,143	72,972	63,318
Income (loss) before cumulative effect of accounting change and extraordinary item	63,586	73,032	57,224	(166,586)	3,959
Extraordinary loss on early extinguishment of debt	(544)	—	—	—	—
Cumulative effect on prior years of change in accounting principle:					
Postemployment benefits	—	—	—	(4,950)	—
Net income (loss)	63,042	73,032	57,224	(171,536)	3,959
<b>Per Share Data</b>					
Income (loss) before cumulative effect of accounting change and extraordinary item - basic and diluted	1.66	1.91	1.50	(4.36)	.10
Extraordinary loss on early extinguishment of debt - basic and diluted	(0.01)	—	—	—	—
Cumulative effect on prior years of change in accounting principle:					
Postemployment benefits - basic and diluted	—	—	—	(.13)	—
Net income (loss) - basic and diluted	1.65	1.91	1.50	(4.49)	.10
Cash dividends	.40	.20	.20	.65	.80
Book value per share	24.22	23.27	21.53	20.27	26.02
<b>Financial Position</b>					
Current assets	1,217,227	1,231,379	1,174,935	1,193,731	1,230,339
Current liabilities	955,130	1,016,005	983,968	1,096,454	1,151,132
Working capital	262,097	215,374	190,967	97,277	79,207
Current ratio	1.27	1.21	1.19	1.09	1.07
Expenditures for property	267,623	296,878	236,139	214,886	267,329
Total assets	2,995,253	3,002,672	2,860,847	2,894,788	3,098,695
Current portion of long-term debt	16,824	18,290	13,040	112,821	77,755
Current portion of capital lease obligations	12,293	12,708	13,125	14,492	16,097
Long-term debt	695,292	701,609	650,169	612,473	544,399
Long-term portion of capital lease obligations	120,980	137,886	129,887	146,400	162,866
Total debt	845,389	870,493	806,221	886,186	801,117
Debt to total capitalization	.48	.49	.49	.53	.45
<b>Equity</b>					
Shareholders' equity	926,632	890,072	822,785	774,914	994,417
Weighted average shares outstanding	38,249,832	38,221,329	38,220,333	38,220,333	38,220,351
Number of registered shareholders	8,029	8,808	10,010	10,867	11,831
<b>Other</b>					
Number of employees	79,980	84,000	89,000	92,000	94,000
New store openings	40	30	30	22	16
Number of stores at year end	936	973	1,014	1,108	1,173
Total store area (square feet)	30,574,286	30,587,324	31,101,589	33,310,121	34,696,265
Number of franchised stores at year end	52	49	7	—	—
Total franchised store area (square feet)	1,389,435	1,345,786	177,936	—	—



## *Executive Officers and Key Operating Management*

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### **Senior Executive Officers**

Christian W.E. Haub  
*President and  
Chief Executive Officer*

Fred Corrado  
*Vice Chairman,  
Chief Financial Officer*

Michael J. Larkin  
*Senior Executive Vice President,  
Chief Operating Officer*

Joseph McCaig  
*Executive Assistant to the  
Chief Executive Officer*

George Graham  
*Executive Vice President,  
Chief Merchandising Officer*

Aaron Malinsky  
*Executive Vice President,  
Development and Strategic  
Planning*

Peter J. O'Gorman  
*Executive Vice President,  
International Store and  
Product Development*

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### **Merchandising/Staff Officers**

H. Nelson Lewis  
*Senior Vice President,  
Human Resources*

Brian Pall  
*Senior Vice President,  
Development*

Michael J. Rourke  
*Senior Vice President,  
Communications  
and Corporate Affairs*

Robert G. Ulrich  
*Senior Vice President  
and General Counsel*

Peter R. Brooker  
*Vice President, Planning  
and Corporate Secretary*

Stephen T. Brown  
*Vice President,  
Industrial Relations*

Timothy J. Courtney  
*Vice President,  
Taxation*

R. Paul Gallant  
*President, Compass Foods*

R. Terrence Galvin  
*Vice President,  
Finance and Treasurer*

Kenneth W. Green  
*Vice President,  
Produce Merchandising  
and Procurement*

Joseph J. Hoffman  
*Vice President,  
Meat Merchandising  
and Procurement*

Robert A. Keenan  
*Vice President,  
Chief Internal Auditor*

Francis X. Leonard  
*Vice President,  
Real Estate Administration*

Mary Ellen Offer  
*Vice President,  
Assistant Corporate Secretary  
and Senior Counsel*

Richard J. Scola  
*Vice President,  
Real Estate Law,  
Assistant General Counsel and  
Assistant Corporate Secretary*

Kenneth A. Uhl  
*Vice President, Controller*

William T. Wolverton  
*Vice President, Warehousing  
and Transportation*

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### **Supermarket Operations**

#### *Canada*

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John Dunne  
*Chairman and  
Co-Chief Executive Officer*

Brian Piwek  
*Vice Chairman and  
Co-Chief Executive Officer*

William McEwan  
*President and Chief  
Merchandising Officer*

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#### *Greater Metro Area*

William Louttit  
*Chairman and  
Chief Executive Officer,  
Greater Metro New York Operations*

Andrew Fuchs  
*President, Metro Group*

David Hoalt  
*President, New England*

Alfred Limbrick  
*President, Super Fresh*

David Smithies  
*President, Waldbaum, Inc.*

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#### *Mid-Atlantic/Southeast/Southern*

Glenn R. Dickson  
*Group Vice President, Southeast*

Donald B. Dobson  
*Group Vice President, Southern*

Herbert Whiteside  
*Group Vice President, Mid-Atlantic*

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#### *Mid-West*

Craig C. Sturken  
*Chairman and  
Chief Executive Officer,  
Mid-West Operations*

James Holt  
*President, Kohl's Food Stores, Inc.*



## Board of Directors

James Wood (c)  
*Chairman of the Board*

John D. Barline, Esq. (e)  
*Williams, Kastner & Gibbs LLP,  
Tacoma, Washington*

Rosemarie Baumeister (b)  
*Executive Vice President,  
Tengelmann  
Warenhandelsgesellschaft,  
Germany*

Fred Corrado (c)(d)(e)  
*Vice Chairman of the Board and  
Chief Financial Officer*

Christopher F. Edley (a)(b)(c)(e)  
*President Emeritus and former  
President and Chief Executive  
Officer of the United Negro  
College Fund, Inc.*

Christian W.E. Haub (c)(d)(e)  
*President and  
Chief Executive Officer*

Helga Haub (c)(d)

Barbara Barnes Hauptfuhrer  
(a)(c)(d)(e)  
*Director of various corporations*

William A. Liffers (a)(c)  
*Former Vice Chairman of American  
Cyanamid Company*

Fritz Teelen (d)  
*Chief Operating Officer of Tengelmann  
Warenhandelsgesellschaft, Germany*

R.L. "Sam" Wetzel (a)(b)(d)(e)  
*President and Chief  
Executive Officer of Wetzel  
International, Inc.*

(a) *Member of  
Audit Review Committee,  
William A. Liffers, Chairman*

(b) *Member of  
Compensation Policy Committee,  
Christopher F. Edley, Chairman*

(c) *Member of Executive Committee,  
James Wood, Chairman*

(d) *Member of Finance Committee,  
R.L. "Sam" Wetzel, Chairman*

(e) *Member of Retirement  
Benefits Committee,  
Barbara Barnes Hauptfuhrer,  
Chairman*

## Shareholder Information

*Executive Offices*  
Box 418  
2 Paragon Drive  
Montvale, NJ 07645  
Telephone 201-573-9700

*Transfer Agent and Registrar*  
American Stock Transfer  
and Trust Company  
40 Wall Street  
New York, NY 10005  
Telephone 212-936-5100

*Independent Auditors*  
Deloitte & Touche LLP  
Two Hilton Court  
Parsippany, NJ 07054

*Shareholder Inquiries and Publications*  
Shareholders, security analysts,  
members of the media and others  
interested in further information about  
the Company are invited to contact  
the Treasury Department at  
the Executive Offices in Montvale,  
New Jersey.

Internet users can access information  
on A&P at: [www.aptea.com](http://www.aptea.com)

Correspondence concerning shareholder  
address changes should be directed to:  
American Stock Transfer and Trust Company  
40 Wall Street  
New York, NY 10005  
Telephone 212-936-5100

*Form 10-K*  
Copies of Form 10-K filed with the  
Securities and Exchange Commission  
will be provided to shareholders upon  
written request to the Secretary at the  
Executive Offices in Montvale,  
New Jersey.

*Annual Meeting*  
The Annual Meeting of Shareholders  
will be held at 10:00 a.m. (E.D.T.) on  
Tuesday, July 14, 1998 at The  
Springfield Marriott Hotel, 1500 Main  
Street, Springfield, Massachusetts.  
Shareholders are cordially invited  
to attend.

### *Common Stock*

Common stock of the Company is  
listed and traded on the New York  
Stock Exchange under the ticker  
symbol "GAP" and has unlisted  
trading privileges on the Boston, Midwest,  
Philadelphia, Cincinnati,  
and Pacific Stock Exchanges.  
The stock is reported in newspapers  
and periodical tables as "GtAtPc."

### *Financial Calendar*

Annual Meeting of Shareholders July 14, 1998

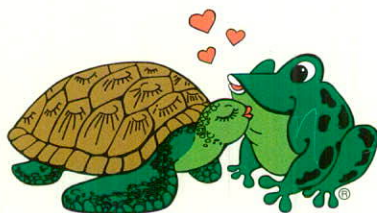
	Estimated Date of Announcement of the Quarter's Results	Estimated Date of Dividend Payment
<b>1st</b>	July 7, 1998	May 1, 1998
<b>2nd</b>	September 29, 1998	August 10, 1998
<b>3rd</b>	December 22, 1998	November 2, 1998
<b>4th</b>	March 16, 1999	February 1, 1999





The Great Atlantic & Pacific Tea Company, Inc.

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recycled paper.*